

**Chubb Tempest Reinsurance Ltd. and its  
subsidiaries**  
(Incorporated in Bermuda)

Consolidated Financial Statements  
**December 31, 2017 and 2016**  
(in thousands of dollars)



## **Report of Independent Auditors**

To the Board of Directors of Chubb Tempest Reinsurance and its subsidiaries:

We have audited the accompanying consolidated financial statements of Chubb Tempest Reinsurance and its subsidiaries ("the Company"), which comprise the consolidated balance sheets as of December 31, 2017 and 2016, and the related consolidated statements of operations and comprehensive income, of shareholder's equity and of cash flows for the years then ended.

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

Management is responsible for the preparation and fair presentation of the 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 the consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our 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, we consider 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 Chubb Tempest Reinsurance and its subsidiaries as of December 31, 2017 and 2016, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

A handwritten signature in black ink that reads "PricewaterhouseCoopers LLP".

April 27, 2018

**Chubb Tempest Reinsurance Ltd. and its subsidiaries**  
**Consolidated Balance Sheets**  
**As at December 31, 2017 and 2016**

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(in thousands of U.S. dollars, except par value)

	<b>2017</b> \$	<b>2016</b> \$
<b>Assets</b>		
Fixed maturities available for sale, at fair value (amortized cost \$11,498,906 and \$10,776,868)	11,733,654	11,038,567
Fixed maturities held to maturity, at amortized cost (fair value \$8,560 and \$10,161)	8,139	9,576
Equity securities, at fair value (cost \$271 and \$2,697)	190	2,572
Short-term investments, at cost and fair value	318,474	326,875
Other investments (cost \$2,159,283 and \$1,989,102)	2,399,887	2,240,600
Cash	762,727	443,746
Total investments and cash	<u>15,223,071</u>	<u>14,061,936</u>
Securities lending collateral	262,815	209,299
Accrued investment income	107,921	102,607
Reinsurance balances receivable	859,917	797,199
Prepaid reinsurance premiums	143,826	160,204
Reinsurance recoverable	1,112,421	751,428
Value of reinsurance business assumed	183,684	199,237
Deferred policy acquisition costs	497,623	349,918
Goodwill	364,958	364,958
Amounts due from affiliates	370,981	293,109
Funds withheld	338,985	342,712
Other assets	55,324	34,013
<b>Total assets</b>	<u>19,521,526</u>	<u>17,666,620</u>
<b>Liabilities</b>		
Unpaid losses and loss expenses	7,178,491	6,256,213
Future policy benefits	1,113,566	992,186
Unearned premiums	1,470,899	1,300,898
Reinsurance balances payable	328,422	341,453
Securities lending payable	262,848	209,368
Accounts payable, accrued expenses and other liabilities	91,752	235,286
Repurchase agreements	551,840	551,937
Amounts due to affiliates	35,973	33,389
<b>Total liabilities</b>	<u>11,033,791</u>	<u>9,920,730</u>
<b>Shareholder's equity</b>		
<b>Chubb Tempest Reinsurance Ltd. shareholder's equity</b>		
Common shares (\$10 par value, 10,000,000 authorized 280,000 issued and outstanding)	2,800	2,800
Additional paid-in capital	2,546,935	2,474,338
Retained earnings	4,879,035	4,250,522
Accumulated other comprehensive income (AOCI)	267,823	322,910
<b>Total Chubb Tempest Reinsurance Ltd. shareholder's equity</b>	<u>7,696,593</u>	<u>7,050,570</u>
Non-controlling interest	791,142	695,320
<b>Total shareholder's equity</b>	<u>8,487,735</u>	<u>7,745,890</u>
<b>Total liabilities and shareholder's equity</b>	<u>19,521,526</u>	<u>17,666,620</u>

The accompanying notes are an integral part of these consolidated financial statements.

**Chubb Tempest Reinsurance Ltd. and its subsidiaries**  
**Consolidated Statements of Operations and Comprehensive Income**  
For the years ended December 31, 2017 and 2016

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(in thousands of dollars)

	2017 \$	2016 \$
<b>Revenues</b>		
Gross premiums written		
Property and casualty premiums	4,337,578	3,885,059
Life and annuity premiums	607,258	576,453
	<hr/>	<hr/>
Reinsurance premiums ceded	4,944,836	4,461,512
Net premiums written	(416,263)	(331,214)
Change in unearned premiums	<hr/>	<hr/>
Net premiums earned	4,528,573	4,130,298
Net investment income	(103,545)	(106,268)
Other income, (net)	<hr/>	<hr/>
Net realized gains (losses):	4,425,028	4,024,030
Other-than-temporary impairment (OTTI) losses gross	551,474	486,222
Portion of OTTI losses recognized in other comprehensive income	268,444	175,157
	<hr/>	<hr/>
Net OTTI losses recognized in income	(18,318)	(35,805)
	<hr/>	<hr/>
Net realized gains (losses) excluding OTTI losses	600	719
Total net realized gains (losses) (includes (\$2,789) and (\$76,480) reclassified from AOCI)	<hr/>	<hr/>
<b>Total revenues</b>	124,266	(69,001)
	<hr/>	<hr/>
<b>Expenses</b>	5,369,212	4,616,408
Losses and loss expenses	<hr/>	<hr/>
Future policy benefits	2,856,571	1,981,273
Policy acquisition costs	20,918	31,029
Administrative expenses	1,324,541	1,252,613
Interest expense	17,658	17,907
<b>Total expenses</b>	21,597	12,818
	<hr/>	<hr/>
	4,241,285	3,295,640
<b>Net Income</b>	<hr/>	<hr/>
Less: Net income attributable to the non-controlling interest	1,127,927	1,320,768
<b>Net Income attributable to Chubb Tempest Reinsurance Ltd.</b>	119,414	73,836
	<hr/>	<hr/>
<b>Other comprehensive income</b>	1,008,513	1,246,932
Unrealized appreciation (depreciation) on investments	<hr/>	<hr/>
Reclassification adjustments for net realized losses included in net income	(51,936)	3,350
	<hr/>	<hr/>
Change in:	2,789	76,480
Cumulative Translation Adjustments	(49,147)	79,830
Other comprehensive income / (loss)	<hr/>	<hr/>
<b>Comprehensive income</b>	(5,940)	24,345
Less: Comprehensive income attributable to the non-controlling interest	(55,087)	104,175
<b>Comprehensive income attributable to Chubb Tempest Reinsurance Ltd.</b>	1,072,840	1,424,943
	115,822	58,205
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	957,018	1,366,738

The accompanying notes are an integral part of these consolidated financial statements.

**Chubb Tempest Reinsurance Ltd. and its subsidiaries**  
**Consolidated Statements of Shareholder's Equity**  
For the years ended December 31, 2017 and 2016

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(in thousands of dollars)

	<b>2017</b> \$	<b>2016</b> \$
<b>Common shares</b>		
Balance – beginning and end of year	2,800	2,800
<b>Additional paid-in capital</b>		
Balance – beginning of year	2,474,338	2,474,338
Change in year	72,597	-
<b>Balance – end of year</b>	<u>2,546,935</u>	<u>2,474,338</u>
<b>Retained earnings</b>		
Balance – beginning of year, as reported	4,250,522	3,603,590
Net income	1,008,513	1,246,932
Dividends declared	(380,000)	(600,000)
<b>Balance - end of year</b>	<u>4,879,035</u>	<u>4,250,522</u>
<b>Accumulated other comprehensive income</b>		
Net unrealized appreciation on investments		
Balance – beginning of year	420,756	340,926
Change in year, before reclassification from AOCI to net income	(51,936)	3,350
Amounts reclassified from AOCI to net income	2,789	76,480
<b>Balance - end of year</b>	<u>371,609</u>	<u>420,756</u>
Cumulative Translation Adjustments		
Balance – beginning of year	(97,846)	(122,191)
Change in year	(5,940)	24,345
<b>Balance - end of year</b>	<u>(103,786)</u>	<u>(97,846)</u>
<b>Accumulated other comprehensive income</b>	<u>267,823</u>	<u>322,910</u>
<b>Total Chubb Tempest Reinsurance Ltd. shareholder's equity</b>	<u>7,696,593</u>	<u>7,050,570</u>
<b>Non-controlling interest</b>		
Balance - beginning of year	695,320	675,448
Distributions to holder of non-controlling interest	(20,000)	(38,333)
Net income	119,414	73,836
Change in year - unrealized depreciation	(3,592)	(15,631)
<b>Total non-controlling interest</b>	<u>791,142</u>	<u>695,320</u>

The accompanying notes are an integral part of these consolidated financial statements.

**Chubb Tempest Reinsurance Ltd. and its subsidiaries**  
**Consolidated Statements of Cash Flows**  
**For the years ended December 31, 2017 and 2016**

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(in thousands of dollars)

	2017 \$	2016 \$
<b>Cash flows from (used in) operating activities</b>		
Net income	1,127,927	1,320,768
Adjustments to reconcile net income to net cash flows from operating activities:		
Net realized (gains) losses	(124,266)	69,001
Amortization of premiums/discounts on fixed maturities	10,947	10,583
Unpaid losses and loss expenses, net of reinsurance recoverable	481,254	71,773
Future policy benefits, net of reinsurance recoverable	1,902	11,006
Unearned premiums	146,338	105,439
Reinsurance balances payable	(15,459)	4,886
Accounts payable, accrued expenses, other liabilities and funds withheld	94,801	20,332
Reinsurance balances receivable	(45,659)	(153,662)
Prepaid reinsurance premiums	18,247	(35,476)
Accrued investment income	(3,510)	5,375
Deferred policy acquisition costs	(125,439)	(78,740)
Value of reinsurance business assumed	15,553	27,287
Amounts (paid to) received from parent and affiliates	(46,789)	(26,137)
Equity earnings	(389,768)	(252,681)
Other	12,397	(80,421)
<b>Net cash flows from operating activities</b>	<b>1,158,476</b>	<b>1,019,333</b>
<b>Cash flows from (used in) investing activities</b>		
Purchases of fixed maturities (available for sale and held to maturity)	(4,005,304)	(3,720,051)
Purchases of equity securities	(5)	(1,999)
Sales of fixed maturities available for sale	1,574,899	2,588,226
Sales of equity securities	1,453	1,190
Maturities and redemptions of fixed maturities available for sale	1,839,293	1,547,663
Maturities and redemptions of fixed maturities held to maturity	1,367	2,992
Net change in short-term investments	11,203	490,090
Net derivative instruments settlements	(5,595)	(8,864)
Net change in other investments	99,248	121,893
Acquisition of subsidiary (net of cash acquired of \$5,058 and \$Nil)	5,058	-
Other	92	5,104
<b>Net cash flows from (used in) investing activities</b>	<b>(478,291)</b>	<b>1,026,244</b>
<b>Cash flows from (used in) financing activities</b>		
Repayment of repurchase agreements	(1,106,990)	(552,765)
Proceeds from issuance of repurchase agreements	1,106,893	553,976
Dividends paid	(380,000)	(2,341,800)
<b>Net cash flows used in financing activities</b>	<b>(380,097)</b>	<b>(2,340,589)</b>
<b>Effect of foreign currency rate change on cash and cash equivalents</b>		
Net increase in cash	18,893	(11,780)
Cash - beginning of year	318,981	(306,792)
<b>Cash - end of year</b>	<b>443,746</b>	<b>750,538</b>
<b>Supplemental cash flow information</b>		
Interest paid	762,727	443,746
	21,635	11,389

The accompanying notes are an integral part of these consolidated financial statements.

# **Chubb Tempest Reinsurance Ltd. and its subsidiaries**

## **Notes to Consolidated Financial Statements**

### **For the years ended December 31, 2017 and 2016**

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#### **1. General**

Chubb Tempest Reinsurance Ltd. (“the Company” or “CTR”) was incorporated under the laws of Bermuda on February 22, 1996 and is a wholly-owned subsidiary of Chubb Tempest Life Reinsurance Ltd. (“CTLR”). The Company’s ultimate parent company is Chubb Limited (“Chubb”). Effective November 1, 2017, a reorganization was completed whereby 100 percent of the shares of ACE European Life Limited (UK) (AELL), a party under common control of Chubb Limited, were transferred to CTR from CTLR (the Transfer). CTR paid no consideration and the net impact of the Transfer was an increase to our additional paid in capital of \$72.6 million. The Accounts of AELL have been consolidated with those of the Company effective on the date of the Transfer. AELL was incorporated under the laws of the UK in 2007.

#### **2. Principal business**

The Company provides property catastrophe, property, casualty, accident and health and life reinsurance for a diverse group of customers worldwide. Net premiums earned by geographic region for the years ended:

	<b>2017</b>	<b>2016</b>
North America	41%	47%
Europe	18%	17%
Asia	24%	22%
Latin America	17%	14%
	<hr/> 100%	<hr/> 100%

#### **3. Significant accounting policies**

##### **(a) Basis of presentation**

The accompanying consolidated financial statements, which include the accounts of the Company and its subsidiaries, have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) and, in the opinion of management, reflect all adjustments (consisting of normally recurring accruals) necessary for a fair statement of the results and financial position for such periods. All significant intercompany accounts and transactions, including internal reinsurance transactions have been eliminated. Certain items in the prior year financial statements have been reclassified to conform to the current year presentation.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Amounts included in the consolidated financial statements reflect the Company’s best estimates and assumptions; actual amounts could differ materially from these estimates. The Company’s principal estimates include:

- unpaid loss and loss expense reserves and future policy benefits reserves;
- the amortization of deferred policy acquisition costs;
- value of reinsurance business assumed;
- reinsurance recoverable, including a provision for uncollectible reinsurance;
- the assessment of risk transfer for certain reinsurance contracts;
- the valuation of the investment portfolio and assessment of other-than-temporary impairments (OTTI);

# **Chubb Tempest Reinsurance Ltd. and its subsidiaries**

## **Notes to Consolidated Financial Statements**

### **For the years ended December 31, 2017 and 2016**

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- the valuation of certain derivatives including those related to guaranteed living benefits (GLB); and
- the assessment of goodwill for impairment.

#### **(b) Premiums**

Premiums are generally recorded as written upon inception of the policy. For multi-year policies for which premiums written are payable in annual installments, only the current annual premium is included as written at policy inception due to the ability of the insured/reinsured to commute or cancel coverage within the term of the policy. The remaining annual premiums are recorded as written at each successive anniversary date within the multi-year term.

For property and casualty (P&C) reinsurance products, premiums written are primarily earned on a pro-rata basis over the terms of the policies to which they relate. Unearned premiums represent the portion of premiums written applicable to the unexpired portion of the policies in force. For retrospectively-rated policies, written premiums are adjusted to reflect expected ultimate premiums consistent with changes to incurred losses, or other measures of exposure as stated in the policy, and earned over the policy coverage period. For retrospectively-rated multi-year policies, premiums recognized in the current period are computed, using a with-and-without method, as the difference between the ceding enterprise's total contract costs before and after the experience under the contract at the reporting date. Accordingly, for retrospectively-rated multi-year policies, additional premiums are generally written and earned when losses are incurred.

Reinsurance premiums from traditional life and annuity policies with life contingencies are generally recognized as revenue when due from policyholders. Traditional life policies include those contracts with fixed and guaranteed premiums and benefits. Benefits and expenses are matched with such income to result in the recognition of profit over the life of the contracts.

Mandatory reinstatement premiums assessed on reinsurance policies are earned in the period of the loss event that gave rise to the reinstatement premiums. All remaining unearned premiums are recognized over the remaining coverage period.

Premiums from long duration contracts such as certain long duration personal accident and health (A&H) policies are generally recognized as revenue when due from policyholders. Benefits and expenses are matched with such income to result in the recognition of profit over the life of the contracts.

Retroactive loss portfolio transfer (LPT) contracts in which the insured loss events occurred prior to the inception of the contract are evaluated to determine whether they meet the established criteria for reinsurance accounting. If reinsurance accounting is appropriate, written premiums are fully earned and corresponding losses and loss expenses recognized at the inception of the contract. The contracts can cause significant variances in gross premiums written, net premiums written, net premiums earned, and net incurred losses in the years in which they are written.

Reinsurance premiums assumed are based on information provided by ceding companies supplemented by the Company's own estimates of premium when the Company has not received ceding company reports. The information used in establishing these estimates is reviewed and adjustments are recorded in the period in which they are determined. Premiums are earned over the coverage terms of the related reinsurance contracts and range from one to three years.

# **Chubb Tempest Reinsurance Ltd. and its subsidiaries**

## **Notes to Consolidated Financial Statements**

### **For the years ended December 31, 2017 and 2016**

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#### **(c) Deferred policy acquisition costs**

Policy acquisition costs consist of commissions, premium taxes, and certain underwriting costs related directly to the successful acquisition of new or renewal insurance contracts. Policy acquisition costs are deferred and amortized. Amortization is recorded in Policy acquisition costs in the consolidated statements of operations. Policy acquisition costs on P&C contracts are generally amortized rateably over the period in which premiums are earned. Policy acquisition costs are reviewed to determine if they are recoverable from future income, including investment income. Unrecoverable policy acquisition costs are expensed in the period identified.

#### **(d) Reinsurance**

The Company assumes and cedes reinsurance with other insurance companies to provide greater diversification of business and minimize the net loss potential arising from large risks. Ceded reinsurance contracts do not relieve the Company of its primary obligation to its policyholders.

For both ceded and assumed reinsurance, risk transfer requirements must be met in order to obtain reinsurance status for accounting purposes, principally resulting in the recognition of cash flows under the contract as premiums and losses. To meet risk transfer requirements, a reinsurance contract must include insurance risk, consisting of both underwriting and timing risk, and a reasonable possibility of a significant loss for the assuming entity. To assess risk transfer for certain contracts, the Company generally develops expected discounted cash flow analyses at contract inception.

Reinsurance recoverable includes the balances due from reinsurance companies for paid and unpaid losses and loss expenses and policy benefits that will be recovered from reinsurers, based on contracts in force. The method for determining the reinsurance recoverable on unpaid losses and loss expenses incurred but not reported (IBNR) involves actuarial estimates consistent with those used to establish the associated liability for unpaid losses and loss expenses as well as a determination of the Company's ability to cede unpaid losses and loss expenses under the terms of the reinsurance agreement.

Reinsurance recoverable is presented net of a provision for uncollectible reinsurance determined based upon a review of the financial condition of the reinsurers and other factors. The provision for uncollectible reinsurance is based on an estimate of the amount of the reinsurance recoverable balance that the Company will ultimately be unable to recover due to reinsurer insolvency, a contractual dispute, or any other reason. The valuation of this provision includes several judgments including certain aspects of the allocation of reinsurance recoverable on IBNR claims by reinsurer and a default analysis to estimate uncollectible reinsurance. The primary components of the default analysis are reinsurance recoverable balances by reinsurer, net of collateral, and default factors used to determine the portion of a reinsurer's balance deemed uncollectible. The definition of collateral for this purpose requires some judgment and is generally limited to assets held in trust, letters of credit, and liabilities held by the Company with the same legal entity for which it believes there is a contractual right of offset. The determination of the default factor is principally based on the financial strength rating of the reinsurer. Default factors require considerable judgment and are determined using the current financial strength rating, or rating equivalent, of each reinsurer as well as other key considerations and assumptions. The more significant considerations include, but are not necessarily limited to, the following:

- For reinsurers that maintain a financial strength rating from a major rating agency, and for which recoverable balances are considered representative of the larger population (i.e., default probabilities are consistent with similarly rated reinsurers and payment durations conform to averages), the financial rating is based on a published source and the default factor is based on published default statistics of a major rating agency applicable to the reinsurer's particular rating

# **Chubb Tempest Reinsurance Ltd. and its subsidiaries**

## **Notes to Consolidated Financial Statements**

### **For the years ended December 31, 2017 and 2016**

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class. When a recoverable is expected to be paid in a brief period of time by a highly rated reinsurer, such as certain property catastrophe claims, a default factor may not be applied;

- For balances recoverable from reinsurers that are both unrated by a major rating agency and for which management is unable to determine a credible rating equivalent based on a parent, affiliate, or peer company, the Company determines a rating equivalent based on an analysis of the reinsurer that considers an assessment of the creditworthiness of the particular entity, industry benchmarks, or other factors as considered appropriate. The Company then applies the applicable default factor for that rating class. For balances recoverable from unrated reinsurers for which the ceded reserve is below a certain threshold, the Company generally applies a default factor of 34 percent, consistent with published statistics of a major rating agency;
- For balances recoverable from reinsurers that are either insolvent or under regulatory supervision, the Company establishes a default factor and resulting provision for uncollectible reinsurance based on reinsurer-specific facts and circumstances. Upon initial notification of an insolvency, the Company generally recognizes expense for a substantial portion of all balances outstanding, net of collateral, through a combination of write-offs of recoverable balances and increases to the provision for uncollectible reinsurance. When regulatory action is taken on a reinsurer, the Company generally recognizes a default factor by estimating an expected recovery on all balances outstanding, net of collateral. When sufficient credible information becomes available, the Company adjusts the provision for uncollectible reinsurance by establishing a default factor pursuant to information received; and
- For other recoverables, management determines the provision for uncollectible reinsurance based on the specific facts and circumstances of that dispute.

The methods used to determine the reinsurance recoverable balance and related provision for uncollectible reinsurance are regularly reviewed and updated and any resulting adjustments are reflected in earnings in the period identified.

Prepaid reinsurance premiums represent the portion of premiums ceded to reinsurers applicable to the unexpired coverage terms of the reinsurance contracts in force.

The value of reinsurance business assumed represents the excess of estimated ultimate value of the liabilities assumed under retroactive reinsurance contracts over consideration received. The value of reinsurance business assumed is amortized and recorded to losses and loss expenses based on the payment pattern of the losses assumed and ranges between 9 and 40 years. The unamortized value is reviewed regularly to determine if it is recoverable based upon the terms of the contract, estimated losses and loss expenses, and anticipated investment income. Unrecoverable amounts are expensed in the period identified.

#### **(e) Investments**

Fixed maturity investments are classified as either available for sale or held to maturity. The available for sale portfolio is reported at fair value. The held to maturity portfolio includes securities for which the Company has the ability and intent to hold to maturity or redemption and is reported at amortized cost. Equity securities are classified as available for sale and are recorded at fair value. Short-term investments comprise securities due to mature within one year of the date of purchase and are recorded at fair value which typically approximates cost. Short-term investments include certain cash and cash equivalents, which are part of investment portfolios under the management of external investment managers.

# **Chubb Tempest Reinsurance Ltd. and its subsidiaries**

## **Notes to Consolidated Financial Statements**

### **For the years ended December 31, 2017 and 2016**

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Included in other investments are investments in hedge funds and private equity investments, made through the investment vehicles Oasis Investments Limited and Oasis Investments 2 Ltd (collectively “Oasis Investments”). The Company is the majority shareholder in Oasis Investments and has the ability to exercise control, and as such, the results of operations and related assets and liabilities of Oasis Investments are consolidated. The non-majority ownership in Oasis Investments is reported as non-controlling interest in the Consolidated Balance Sheets and Statements of Operations and Comprehensive Income. As a result of the timing of the receipt of valuation data from the investment managers, these investments are generally reported on a three month lag.

Other investments also include direct investments in partially-owned insurance companies over which the Company has significant influence and, as such, meet the requirements for equity accounting. The Company reports its share of the net income or loss of the partially-owned insurance companies in Other income (expense).

Other investments for which the Company cannot exercise significant influence, are carried at fair value.

Realized gains or losses on sales of investments are determined on a first-in, first-out basis. Unrealized appreciation (depreciation) on investments is included as a separate component of AOCI in shareholder’s equity. The Company regularly reviews its investments for OTTI. Refer to Note 4.

With respect to securities where the decline in value is determined to be temporary and the security’s value is not written down, a subsequent decision may be made to sell that security and realize a loss. Subsequent decisions on security sales are the result of changing or unforeseen facts and circumstances (e.g., arising from a large insured loss such as a catastrophe), deterioration of the creditworthiness of the issuer or its industry, or changes in regulatory requirements. The Company believes that subsequent decisions to sell such securities are consistent with the classification of the majority of the portfolio as available for sale.

The Company uses derivative instruments including futures, options, and foreign currency forward contracts for the purpose of managing certain investment portfolio risks and exposures. Refer to Note 8. Derivatives are reported at fair value and recorded in the accompanying consolidated balance sheets in Other assets or Accounts payable, accrued expenses, and other liabilities with changes in fair value included in Net realized gains (losses) in the consolidated statements of operations. Collateral held by brokers equal to a percentage of the total value of open futures contracts is included in the investment portfolio.

Net investment income includes interest and dividend income together with amortization of fixed maturity market premiums and discounts and is net of investment management and custody fees. For mortgage-backed securities, and any other holdings for which there is a prepayment risk, prepayment assumptions are evaluated and revised as necessary. Any adjustments required due to the resultant change in effective yields and maturities are recognized prospectively. Prepayment fees or call premiums that are only payable when a security is called prior to its maturity are earned when received and reflected in Net investment income.

The Company participates in a securities lending program operated by a third party banking institution whereby certain assets are loaned to qualified borrowers and from which the Company earns an incremental return. Borrowers provide collateral, in the form of either cash or approved securities, of 102 percent of the fair value of the loaned securities. Each security loan is deemed to be an overnight transaction. Cash collateral is invested in a collateral pool which is managed by the banking institution. The collateral pool is subject to written investment guidelines with key objectives which

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## **Notes to Consolidated Financial Statements**

### **For the years ended December 31, 2017 and 2016**

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include the safeguard of principal and adequate liquidity to meet anticipated redemptions. The fair value of the loaned securities is monitored on a daily basis, with additional collateral obtained or refunded as the fair value of the loaned securities changes.

The collateral is held by the third party banking institution, and the collateral can only be accessed in the event that the institution borrowing the securities is in default under the lending agreement. As a result of these restrictions, the Company considers its securities lending activities to be non-cash investing and financing activities. An indemnification agreement with the lending agent protects the Company in the event a borrower becomes insolvent or fails to return any of the securities on loan. The fair value of the securities on loan is included in fixed maturities and equity securities. The securities lending collateral is reported as a separate line in total assets with a related liability reflecting the Company's obligation to return the collateral plus interest.

Similar to securities lending arrangements, securities sold under reverse repurchase agreements, whereby the Company sells securities and repurchases them at a future date for a predetermined price, are accounted for as collateralized investments and borrowings and are recorded at the contractual repurchase amounts plus accrued interest. Assets to be repurchased are the same, or substantially the same, as the assets transferred and the transferor, through right of substitution, maintains the right and ability to redeem the collateral on short notice. The fair value of the underlying securities is included in fixed maturities. In contrast to securities lending programs, the use of cash received is not restricted. The Company reports the obligation to return the cash as Repurchase agreements in the consolidated balance sheets.

Refer to Note 10 for a discussion on the determination of fair value for the Company's various investment securities.

**(f) Cash**

Cash includes cash on hand and deposits with an original maturity of three months or less at time of purchase. Cash held by external money managers is included in Short-term investments.

Chubb Limited has agreements with a third party bank provider which implemented two international multi-currency notional cash pooling programs. In each program, participating Chubb entities establish deposit accounts in different currencies with the bank provider and each day the credit or debit balances in every account are notionally translated into a single currency (U.S. dollars) and then notionally pooled. The bank extends overdraft credit to any participating Chubb entity as needed, provided that the overall notionally-pooled balance of all accounts in each pool at the end of each day is at least zero. Actual cash balances are not physically converted and are not commingled between legal entities. Any overdraft balances incurred under this program by a Chubb entity would be guaranteed by Chubb Limited (up to \$300 million in the aggregate). The syndicated letter of credit facility allows for same day drawings to fund a net pool overdraft should participating Chubb entities withdraw contributed funds from the pool. The Company is a participating Chubb entity.

**(g) Goodwill**

Goodwill represents the excess of the cost of acquisitions over the fair value of net assets acquired and is not amortized. Goodwill is assigned at acquisition to the applicable reporting unit of the acquired entities giving rise to the goodwill. Goodwill impairment tests are performed annually, or more frequently if circumstances indicate a possible impairment. For goodwill impairment testing, the Company uses a qualitative assessment to determine whether it is more likely than not (i.e., more than a 50 percent probability) that the fair value of a reporting unit is greater than its carrying amount. If assessment indicates less than a 50 percent probability that fair value exceeds carrying value, the Company quantitatively estimates a reporting unit's fair value.

# **Chubb Tempest Reinsurance Ltd. and its subsidiaries**

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#### **(h) Unpaid losses and loss expenses**

A liability is established for the estimated unpaid losses and loss expenses under the terms of, and with respect to, the Company's policies and agreements. Similar to premiums that are recognized as revenues over the coverage period of the policy, a liability for unpaid losses and loss expenses is recognized as expense when insured events occur over the coverage period of the policy. These amounts include provision for both reported claims (case reserves) and incurred but not reported (IBNR) claims. IBNR reserve estimates are generally calculated by first projecting the ultimate cost of all losses that have occurred (expected losses), and then subtracting paid losses, case reserves, and loss expenses. The methods of determining such estimates and establishing the resulting liability are reviewed regularly and any adjustments are reflected in operations in the period in which they become known. Future developments may result in losses and loss expenses materially greater or less than the recorded amounts. The Company does not discount its property and casualty loss reserves.

Prior period development arises from changes to loss estimates recognized in the current year that relate to loss reserves first reported in previous calendar years and excludes the effect of losses from the development of earned premiums from previous accident years.

For purposes of analysis and disclosure, management views prior period development to be changes in the nominal value of loss estimates from period to period, net of premium and profit commission adjustments on loss sensitive contracts. Prior period development generally excludes changes in loss estimates that do not arise from the emergence of claims, such as those related to uncollectible reinsurance, interest, unallocated loss adjustment expenses, or foreign currency. Accordingly, specific items excluded from prior period development include the following: gains/losses related to foreign currency remeasurement; losses recognized from the early termination or commutation of reinsurance agreements that principally relate to the time value of money; changes in the value of reinsurance business assumed reflected in losses incurred but principally related to the time value of money; and losses that arise from changes in estimates of earned premiums from prior accident years. Except for foreign currency remeasurement, which is included in Net realized gains (losses), these items are included in current year losses.

#### **(i) Future policy benefits**

The valuation of long-duration contract reserves requires management to make estimates and assumptions regarding expenses, mortality, persistency, and investment yields. Estimates are primarily based on historical experience and information provided by ceding companies and includes a margin for adverse deviation. Interest rates used in calculating reserves range from less than 1.0 percent to 4.5 percent for both December 31, 2017 and 2016. Actual results could differ materially from these estimates. Management monitors actual experience and where circumstances warrant, will revise assumptions and the related reserve estimates. Revisions are recorded in the period they are determined.

#### **(j) Assumed reinsurance programs involving minimum benefit guarantees under annuity contracts**

The Company reinsures various living benefit guarantees (GLB) associated with variable annuities issued in the United States. The Company generally receives a monthly premium during the accumulation phase of the covered annuities (in-force) based on a percentage of the underlying accumulated guaranteed values. Depending on an annuitant's age, the accumulation phase can last many years. To limit our exposure under these programs, all reinsurance treaties include annual or aggregate claim limits and many include an aggregate deductible.

Under reinsurance programs covering GLBs, the Company assumes the risk of guaranteed minimum income benefits (GMIB) and guaranteed minimum accumulation benefits (GMAB) associated with

# **Chubb Tempest Reinsurance Ltd. and its subsidiaries**

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variable annuity contracts. The GMIB risk is triggered if, at the time the contract holder elects to convert the accumulated account value to a periodic payment stream (annuitize), the accumulated account value is not sufficient to provide a guaranteed minimum level of monthly income. The GMAB risk is triggered if, at contract maturity, the contract holder's account value is less than a guaranteed minimum value. The GLB reinsurance product meets the definition of a derivative for accounting purposes and is carried at fair value with changes in fair value recognized in income. Refer to Note 8 and Note 11 for additional information.

(k) **Foreign currency remeasurement and translation**

The functional currency for each of our foreign operations is generally the currency of the local operating environment. Transactions in currencies other than the operation's functional currency are remeasured into the functional currency and the resulting foreign exchange gains and losses are reflected in Net realized gains (losses) in the consolidated statements of operations. Functional currency assets and liabilities are translated into the reporting currency, U.S. dollars, using period end rates of exchange and the related translation adjustments are recorded as a separate component of AOCI. Functional statement of operations amounts expressed in functional currencies are translated using average exchange rates.

(l) **Administrative expenses**

Administrative expenses generally include all operating costs other than policy acquisition costs.

(m) **Cash flow information**

Premiums received and losses paid associated with the GLB reinsurance products, which as discussed previously meet the definition of a derivative instrument for accounting purposes, are included within Cash flows from operating activities. Cash flows, such as settlements and collateral requirements, associated with GLB and all other derivative instruments are included on a net basis within Cash flows from investing activities. Purchases, sales, and maturities of short-term investments are recorded on a net basis within Cash flows from investing activities.

The 2017 AELL transfer was a non-cash transaction and is therefore excluded from the Consolidated Statements of Cash Flows, except for the cash acquired.

(n) **Derivatives**

The Company recognizes all derivatives at fair value in the consolidated balance sheets and participates in derivative instruments in two principal ways as follows:

- (i) To sell protection to customers as an insurance or reinsurance contract that meets the definition of a derivative for accounting purposes. For 2017 and 2016, the reinsurance of GLBs was the Company's primary product falling into this category; and
- (ii) To mitigate financial risks, principally arising from investment holdings, products sold, or assets and liabilities held in foreign currencies. For these instruments, changes in assets or liabilities measured at fair value are recorded as realized gains or losses in the consolidated statement of operations.

During 2017 and 2016, the Company did not designate any derivatives as hedges.

(o) **Share-based compensation**

The Company receives an allocation of share based compensation costs from its ultimate parent, Chubb Limited. Chubb Limited measures and records compensation cost for all share-based payment awards at grant-date fair value. Compensation costs are recognized for share-based payment awards

# **Chubb Tempest Reinsurance Ltd. and its subsidiaries**

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### **For the years ended December 31, 2017 and 2016**

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with only service conditions that have graded vesting schedules on a straight-line basis over the requisite service period for each separately vesting portion of the award as if the award was, in substance, multiple awards.

#### **(p) New accounting pronouncements**

##### **Adopted in 2017**

###### ***Stock Compensation***

Effective January 2017, we prospectively adopted new guidance on stock compensation which requires recognition of the excess tax benefits or deficiencies of share-based compensation awards to employees through net income rather than through additional paid in capital. The calculation of the excess tax benefits or deficiencies is based on the difference between the market value of a stock award at the date of vesting, or at the time of exercise for a stock option, compared to the grant date fair value recognized as compensation expense in the Consolidated statements of operations. The adoption of this guidance did not have an impact on our financial condition or results of operations. Additionally, the guidance allowed for an election to account for forfeitures related to share-based payments either as they occur or through an estimation method. We elected to retain our current accounting for compensation expense using a forfeiture estimation process.

###### ***Short-Duration Contracts***

In May 2015, the FASB issued guidance that requires additional disclosures for short-duration insurance contracts. We adopted this disclosure as of December 31, 2017, and have included in Note 7, new disclosures that provide more information about initial claim estimates and subsequent adjustments to those estimates, the methodologies and judgments used to estimate claims, and the timing, and severity of claims. This guidance requires a change in disclosure only and adoption of this guidance did not have an impact on our financial condition or results of operations.

##### **Adopted in 2018**

###### ***Financial Instruments – Recognition and Measurement of Financial Assets and Financial Liabilities***

In January 2016, the FASB issued guidance that affects the recognition, measurement, presentation, and disclosure of financial instruments. The guidance requires equity investments to be measured at fair value with changes in fair value recognized through net income (other than those accounted for under equity method of accounting or those that result in consolidation of the investee) and an assessment of a valuation allowance on deferred tax assets related to unrealized losses of available for sale (AFS) debt securities in combination with other deferred tax assets. The standard was effective for us in the first quarter of 2018 and required recognition of a cumulative effect adjustment at adoption to beginning retained earnings. The adoption of this guidance did not have a material impact on our financial condition or results of operations.

###### ***Statement of Cash Flows***

In August 2016, the FASB issued guidance clarifying the classification of certain cash receipts and cash payments within the statement of cash flows, including distributions received from equity method investments. The guidance requires entities to make an accounting policy election to present cash flows received either in operating cash flows or investing cash flows based on cumulative equity-method earnings or on the nature of the distributions. We adopted this guidance effective January 1,

# **Chubb Tempest Reinsurance Ltd. and its subsidiaries**

## **Notes to Consolidated Financial Statements**

### **For the years ended December 31, 2017 and 2016**

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2018 and elected to retain our current presentation of cash receipts and cash payments based on the nature of the distributions.

#### ***Goodwill Impairment***

In January 2017, the FASB issued updated guidance on goodwill impairment testing that eliminates Step 2 of the goodwill impairment test requiring entities to calculate the implied fair value of goodwill through a hypothetical purchase price allocation. Under the updated guidance, impairment will now be recognized as the amount by which a reporting unit's carrying value exceeds its fair value. Although the standard would have been effective for us in the first quarter of 2020 on a prospective basis, we adopted this guidance early effective January 1, 2018, as permitted. The adoption of this guidance did not have an impact on our financial condition or results of operations.

#### ***Accounting guidance not yet adopted***

##### ***Premium Amortization on Purchased Callable Debt Securities***

In March 2017, the FASB issued guidance on the amortization period for purchased callable debt securities held at a premium. The guidance requires the premium to be amortized to the earliest call date. Under current guidance, premiums generally are amortized over the contracted life of the security. This guidance is effective for us in the first quarter of 2019 on a modified retrospective basis through a cumulative effect adjustment to beginning retained earnings. Early adoption is permitted. Securities held at a discount do not require an accounting change. Based on our best estimate at the time of this filing, the cumulative effect of the adjustment at the time of adoption is not expected to have a material impact on our financial condition or results of operations.

##### ***Lease Accounting***

In February 2016, the FASB issued accounting guidance requiring leases with lease terms of more than 12 months to recognize a right of use asset and a corresponding lease liability on the balance sheets. This accounting guidance is effective for us in the first quarter of 2019 on a modified retrospective basis with early adoption permitted. In January 2018, the FASB issued a proposed update that provides an alternative transition method of adoption, permitting the recognition of a cumulative-effect adjustment to retained earnings on the date of adoption. We currently believe the most significant impact relates to our real estate operating leases and the related recognition of right-of-use assets and lease liabilities in our consolidated balance sheet. The guidance is not expected to materially impact our financial condition or results of operations other than the recognition of the right of use asset and lease liability.

##### ***Financial Instruments – Credit Losses: Measurement of Credit Losses on Financial Instruments***

In June 2016, the FASB issued guidance on the accounting for credit losses of financial instruments that are measured at amortized cost, including held to maturity securities and reinsurance recoverables, by applying an approach based on the current expected credit losses (CECL). The estimate of expected credit losses should consider historical information, current information, as well as reasonable and supportable forecasts, including estimates of prepayments. The allowance for credit losses is a valuation account that is deducted from the amortized cost basis of the financial asset in order to present the net carrying value at the amount expected to be collected on the financial asset on the Consolidated balance sheet.

The guidance also amends the current debt security other-than-temporary impairment model by requiring an estimate of the expected credit loss (ECL) only when the fair value is below the amortized cost of the asset. The length of time the fair value of an AFS debt security has been below the amortized cost will no longer impact the determination of whether a potential credit loss exists. The AFS debt security model will also require the use of a valuation allowance as compared to the current practice of writing down the asset.

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The standard is effective for us in the first quarter of 2020 with early adoption permitted in the first quarter of 2019. We will be able to assess the effect of adopting this guidance on our financial condition and results of operations closer to the date of adoption.

#### 4. Investments

##### (a) Fixed maturities

	<b>December 31, 2017</b>					
	Amortized Cost	Gross Unrealized Appreciation	Gross Unrealized Depreciation	Fair Value	OTTI Recognize d in AOCI	
	(in thousands of U.S. dollars)					
<b><u>Available for sale</u></b>						
U.S. Treasury and agency	\$ 735,066	\$ 8,284	\$ (4,920)	\$ 738,430	\$ -	-
Foreign	3,185,207	113,304	(26,043)	3,272,468	-	-
Corporate securities	4,617,249	136,416	(15,327)	4,738,338	(942)	
Mortgage-backed securities	2,745,355	35,229	(17,491)	2,763,093	(125)	
States, municipalities, and political subdivisions	216,029	7,582	(2,286)	221,325	-	
	<u>\$ 11,498,906</u>	<u>\$ 300,815</u>	<u>\$ (66,067)</u>	<u>\$ 11,733,654</u>	<u>\$ (1,067)</u>	
<b><u>Held to maturity</u></b>						
Corporate securities	\$ 2,258	\$ 135	\$ -	\$ 2,393	\$ -	-
Mortgage-backed securities	5,881	286	-	6,167	-	-
	<u>\$ 8,139</u>	<u>\$ 421</u>	<u>\$ -</u>	<u>\$ 8,560</u>	<u>\$ -</u>	
 <b><u>December 31, 2016</u></b>						
	Amortized Cost	Gross Unrealized Appreciation	Gross Unrealized Depreciation	Fair Value	OTTI Recognized in AOCI	
	(in thousands of U.S. dollars)					
<b><u>Available for sale</u></b>						
U.S. Treasury and agency	\$ 808,062	\$ 8,461	\$ (8,580)	\$ 807,943	\$ -	-
Foreign	2,699,096	119,154	(22,768)	2,795,482	(533)	
Corporate securities	4,502,389	165,154	(25,539)	4,642,004	(2,134)	
Mortgage-backed securities	2,549,006	41,969	(20,006)	2,570,969	(154)	
States, municipalities, and political subdivisions	218,315	7,358	(3,504)	222,169	-	
	<u>\$ 10,776,868</u>	<u>\$ 342,096</u>	<u>\$ (80,397)</u>	<u>\$ 11,038,567</u>	<u>\$ (2,821)</u>	
<b><u>Held to maturity</u></b>						
Corporate securities	\$ 2,465	\$ 193	\$ -	\$ 2,658	\$ -	-
Mortgage-backed securities	7,111	392	-	7,503	-	-
	<u>\$ 9,576</u>	<u>\$ 585</u>	<u>\$ -</u>	<u>\$ 10,161</u>	<u>\$ -</u>	

# Chubb Tempest Reinsurance Ltd. and its subsidiaries

## Notes to Consolidated Financial Statements

### For the years ended December 31, 2017 and 2016

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As discussed in Note 4 (d), if a credit loss is incurred on an impaired fixed maturity investment, an OTTI is considered to have occurred and the portion of the impairment not related to credit losses (non-credit OTTI) is recognized in Other comprehensive income (OCI). Included in “OTTI Recognized in AOCI” columns above are the cumulative amount of non-credit OTTI recognized in OCI adjusted for subsequent sales, maturities, and redemptions. OTTI recognized in AOCI does not include the impact of subsequent changes in fair value of the related securities. In periods subsequent to a recognition of OTTI in OCI, changes in the fair value of the related fixed maturity investments are reflected in Net unrealized appreciation (depreciation) on investments in the Consolidated statements of shareholder's equity. For the years ended December 31, 2017 and 2016, \$0.9 million net unrealized depreciation and \$17.5 million of net unrealized appreciation, respectively, related to such securities is included in OCI. At December 31, 2017 and 2016, AOCI included net unrealized appreciation of \$0.7 million and a net unrealized appreciation of \$2.3 million, respectively, related to securities remaining in the investment portfolio for which a non-credit OTTI was recognized.

Mortgage-backed securities issued by U.S. government agencies are combined with all other “to be announced” mortgage derivatives held (refer to Note 8 (a)) and are included in the category, “Mortgage-backed securities”. Approximately 85 percent and 88 percent of the total mortgage-backed securities at December 31, 2017 and 2016 are represented by investments in U.S. government agency bonds. The remainder of the mortgage exposure consists of collateralized mortgage obligations and non-government mortgage-backed securities, the majority of which provide a planned structure for principal and interest payments and carry a rating of AAA by the major credit rating agencies.

The following table presents fixed maturities by contractual maturity at December 31, 2017 and 2016.

	2017		2016	
	Fair Value	Amortized Cost	Fair Value	Amortized Cost
	(in thousands of U.S. dollars)			
<b><u>Available for sale; maturity period</u></b>				
Due in 1 year or less	\$ 718,836	\$ 712,320	\$ 707,167	\$ 697,787
Due after 1 year through 5 years	3,448,241	3,363,127	3,604,697	3,468,054
Due after 5 years through 10 years	3,821,112	3,754,043	3,503,824	3,445,318
Due after 10 years	982,372	924,061	651,910	616,703
	8,970,561	8,753,551	8,467,598	8,227,862
Mortgage-backed securities	2,763,093	2,745,355	2,570,969	2,549,006
	\$ 11,733,654	\$ 11,498,906	\$ 11,038,567	\$ 10,776,868
<b><u>Held to maturity; maturity period</u></b>				
Due in 1 year or less	\$ -	\$ -	\$ -	\$ -
Due after 1 year through 5 years	1,638	1,524	1,714	1,559
Due after 5 years through 10 years	-	-	-	-
Due after 10 years	755	734	944	906
	2,393	2,258	2,658	2,465
Mortgage-backed securities	6,167	5,881	7,503	7,111
	\$ 8,560	\$ 8,139	\$ 10,161	\$ 9,576

Expected maturities could differ from contractual maturities because borrowers may have the right to call or prepay obligations, with or without call or prepayment penalties.

**Chubb Tempest Reinsurance Ltd. and its subsidiaries**  
**Notes to Consolidated Financial Statements**  
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(b) **Equity securities**

(in thousands of U.S. dollars)	December 31, 2017	December 31, 2016
Equity securities - cost	\$271	\$2,697
Gross unrealized appreciation	-	348
Gross unrealized depreciation	(81)	(473)
Equity securities – fair value	<u>\$190</u>	<u>\$2,572</u>

(c) **Other investments**

(in thousands of U.S. dollars)	December 31, 2017		December 31, 2016	
	Fair Value/Carrying Value	Cost	Fair Value/Carrying Value	Cost
Hedge funds and private equity investments	2,025,711	1,785,904	1,894,481	1,643,782
Huatai Insurance Company (Percentage ownership 9.9%)	214,000	213,203	217,973	217,174
ABR Reinsurance Ltd. (Percentage ownership 11.3%)	93,077	93,077	96,447	96,447
Other	<u>67,099</u>	<u>67,099</u>	<u>31,699</u>	<u>31,699</u>
	<u>2,399,887</u>	<u>2,159,283</u>	<u>2,240,600</u>	<u>1,989,102</u>

The hedge funds and private equity investments are made through the investment vehicles Oasis Investments Limited and Oasis Investments 2 Ltd. Oasis Investments Limited and Oasis Investments 2 Ltd are consolidated in these financial statements as the Company owns 66.6%. There has been no change in the ownership percentages held during 2017.

The Company owns 11.3 percent of the common equity of ABR Reinsurance Capital Holdings Ltd. and warrants to acquire 0.5 percent of additional equity. ABR Reinsurance Capital Holdings Ltd., is the parent company of ABR Reinsurance Ltd. (ABR Re), an independent reinsurance company. Through long-term arrangements, Chubb will be the sole source of reinsurance risks ceded to ABR Re, and BlackRock, Inc. will be ABR Re's exclusive investment management service provider. As an investor, the Company is expected to benefit from underwriting profit generated by ABR Re's reinsuring a wide range of Chubb's primary insurance business and the income and capital appreciation BlackRock, Inc. seeks to deliver through its investment management services. In addition, Chubb entered into an arrangement with BlackRock, Inc. under which both Chubb and BlackRock, Inc. will be entitled to an equal share of the aggregate amount of certain fees, including underwriting and investment management performance related fees, in connection with their respective reinsurance and investment management arrangements with ABR Re.

ABR Re is a variable interest entity; however, the Company is not the primary beneficiary and does not consolidate ABR Re because the Company does not have the power to control and direct ABR Re's most significant activities, including investing and underwriting. The Company's minority ownership interest is accounted for under the equity method of accounting. Chubb cedes premiums to

# **Chubb Tempest Reinsurance Ltd. and its subsidiaries**

## **Notes to Consolidated Financial Statements**

### **For the years ended December 31, 2017 and 2016**

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ABR Re and recognizes the associated commissions. For the years ended 2017 and 2016, Chubb ceded reinsurance premiums of \$79.8 million and \$76.6 million, respectively and recognized ceded commissions of \$11.2 million and \$12.4 million, respectively. At December 31, 2017 and 2016, the amount of Reinsurance recoverable on losses and loss expenses was \$107.9 million and \$53.2 million, respectively and the amount of ceded reinsurance prepaid premiums was \$0.2 million and \$3.4 million, respectively.

#### **(d) Net realized gains (losses)**

In accordance with guidance related to the recognition and presentation of OTTI, when an impairment related to a fixed maturity has occurred, OTTI is required to be recorded in net income if management has the intent to sell the security or it is more likely than not that the Company will be required to sell the security before the recovery of its amortized cost. Further, in cases where the Company does not intend to sell the security and it is more likely than not that the Company will not be required to sell the security, the Company must evaluate the security to determine the portion of the impairment, if any, related to credit losses. If a credit loss is incurred, an OTTI is considered to have occurred and any portion of the OTTI related to credit losses must be reflected in net income while the portion of OTTI related to all other factors is recognized in OCI. For fixed maturities held to maturity, OTTI recognized in OCI is accreted from AOCI to the amortized cost of the fixed maturity prospectively over the remaining term of the securities.

Each quarter, securities in an unrealized loss position (impaired securities), including fixed maturities, securities lending collateral, equity securities, and other investments, are reviewed to identify impaired securities to be specifically evaluated for a potential OTTI.

For all non-fixed maturities, OTTI is evaluated based on the following:

- the amount of time a security has been in a loss position and the magnitude of the loss position;
- the period in which cost is expected to be recovered, if at all, based on various criteria including economic conditions and other issuer-specific developments; and
- the Company's ability and intent to hold the security to the expected recovery period.

As a general rule, equity securities in an unrealized loss position for twelve consecutive months are considered to be impaired. For mutual funds included in equity securities in our consolidated balance sheet, we employ analysis similar to fixed maturities, when applicable.

#### ***Evaluation of potential credit losses related to fixed maturities***

The Company reviews each fixed maturity in an unrealized loss position to assess whether the security is a candidate for credit loss. Specifically, the Company consider credit rating, market price, and issuer-specific financial information, among other factors, to assess the likelihood of collection of all principal and interest as contractually due. Securities for which the Company determine that credit loss is likely are subjected to further analysis to estimate the credit loss recognized in Net income, if any. In general, credit loss recognized in Net income equals the difference between the security's amortized cost and the net present value of its projected future cash flows discounted at the effective interest rate implicit in the debt security. All significant assumptions used in determining credit losses are subject to change as market conditions evolve.

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#### ***U.S. Treasury and agency obligations (including agency mortgage-backed securities), foreign government obligations, and states, municipalities, and political subdivisions obligations***

U.S. Treasury and agency obligations (including agency mortgage-backed securities), foreign government obligations, and states, municipalities, and political subdivisions obligations represent \$41.3 million of gross unrealized loss at December 31, 2017. These securities were evaluated for credit loss primarily using qualitative assessments of the likelihood of credit loss considering credit rating of the issuers and level of credit enhancement, if any. The Company concluded that the high level of creditworthiness of the issuers coupled with credit enhancement, where applicable, supports recognizing no credit loss in net income.

#### ***Corporate securities***

Projected cash flows for corporate securities (principally senior unsecured bonds) are driven primarily by assumptions regarding probability of default and also the timing and amount of recoveries associated with defaults. The Company developed projected cash flows for corporate securities using market observable data, issuer-specific information, and credit ratings. We use historical default data by Moody's Investors Service (Moody's) rating category to calculate a 1-in-100 year probability of default, which results in a default assumption in excess of the historical mean default rate. Consistent with management's approach, the Company assumed a 32 percent recovery rate (the par value of a defaulted security that will be recovered) across all rating categories rather than using Moody's historical mean recovery rate of 42 percent. The Company believes that use of a default assumption in excess of the historical mean is conservative in light of current market conditions.

The following table presents default assumptions by Moody's rating category (historical mean default rate provided for comparison).

<b>Moody's Rating Category</b>	<b>1-in-100 Year</b>	<b>Historical Mean</b>
	<b>Default Rate</b>	<b>Default Rate</b>
<i>Investment Grade:</i>		
Aaa-Baa	0.0-1.3%	0.0-0.3%
<i>Below Investment Grade:</i>		
Ba	4.8%	1.0%
B	12.1%	3.2%
Caa-C	36.8%	10.5%

Application of the methodology and assumptions described above resulted in credit losses recognized in net income for corporate securities for the years ended December 31, 2017 and 2016 of \$2.3 million and \$4.1 million, respectively.

#### ***Mortgage-backed securities***

For mortgage-backed securities, credit impairment is assessed using a cash flow model that estimates the cash flows on the underlying mortgages, using the security-specific collateral and transaction structure. The model estimates cash flows from the underlying mortgage loans and distributes those cash flows to various tranches of securities, considering the transaction structure and any subordination and credit enhancements that exist in that structure. The cash flow model incorporates actual cash flows on the mortgage-backed securities through the current period and then projects the remaining cash flows using a number of assumptions, including default rates, prepayment rates, and

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loss severity rates (the par value of a defaulted security that will not be recovered) on foreclosed properties.

The Company develops specific assumptions using market data, where available, and includes internal estimates as well as estimates published by rating agencies and other third-party sources. The Company projects default rates by mortgage sector considering current underlying mortgage loan performance, generally assuming lower loss severity for Prime sector bonds versus ALT-A and Sub-prime bonds.

These estimates are extrapolated along a default timing curve to estimate the total lifetime pool default rate. Other assumptions used contemplate the actual collateral attributes, including geographic concentrations, rating agency loss projections, rating actions, and current market prices. If cash flow projections indicate that losses will exceed the credit enhancement for a given tranche, then the Company does not expect to recover the Company's amortized cost basis and the Company recognizes an estimated credit loss in Net income.

There were no credit losses recognized in Net income for mortgage-backed securities for the years ended December 31, 2017 and 2016.

The following table presents, for the years ended December 31, 2017 and 2016, the net realized gains (losses) and the losses included in Net realized gains (losses) and OCI as a result of conditions which caused us to conclude the decline in fair value of certain investments was "other-than-temporary" and the change in net unrealized appreciation (depreciation) on investments.

(in thousands of U.S. dollars)	2017	2016
<b><u>Fixed maturities</u></b>		
OTTI on fixed maturities, gross	\$ (12,914)	\$ (26,751)
OTTI on fixed maturities recognized in other comprehensive income (pre-tax)	600	719
OTTI on fixed maturities, net	(12,314)	(26,032)
Gross realized gains excluding OTTI	26,782	31,602
Gross realized losses excluding OTTI	(16,277)	(82,027)
Total fixed maturities	(1,809)	(76,457)
<b><u>Equity securities:</u></b>		
OTTI on equity securities	(1,303)	(238)
Gross realized gains excluding OTTI	323	215
Total equity securities	(980)	(23)
OTTI on other investments	(4,101)	(8,816)
Foreign exchange losses	32,878	(5,729)
Derivative instruments	98,313	12,047
Other	(35)	9,977
Net realized gains (losses)	124,266	(69,001)
Change in net unrealized appreciation (depreciation) on investments:		
Fixed maturities available for sale	(41,691)	112,393
Fixed maturities held to maturity	(243)	(365)
Equity securities	44	(800)
Other	(7,257)	(31,398)
Change in net unrealized appreciation (depreciation) on investments	(49,147)	79,830
Total net realized gains (losses) and change in net unrealized appreciation (depreciation) on investments	\$ 75,119	\$ 10,829

# Chubb Tempest Reinsurance Ltd. and its subsidiaries

## Notes to Consolidated Financial Statements

### For the years ended December 31, 2017 and 2016

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The following table presents, for the years ended December 31, 2017 and December 31, 2016, a roll-forward of pre-tax credit losses related to fixed maturities for which a portion of OTTI was recognized in OCI.

(in thousands of U.S. dollars)	2017	2016
Balance of credit losses related to securities still held-beginning of period	\$ 6,980	\$ 16,132
Additions where no OTTI was previously recorded	1,944	2,557
Additions where an OTTI was previously recorded	406	1,590
Reductions for securities sold during the period	<u>(5,102)</u>	<u>(13,299)</u>
Balance of credit losses related to securities still held-end of period	<u>\$ 4,228</u>	<u>\$ 6,980</u>

**(e) Gross unrealized loss**

At December 31, 2017, there were 1,007 fixed maturities out of a total of 4,340 fixed maturities in an unrealized loss position. The largest single unrealized loss in the fixed maturities was \$1.8 million. There were 5 equity securities out of a total of 8 equity securities in an unrealized loss position. The largest single unrealized loss in the equity securities was \$0.1 million. Fixed maturities in an unrealized loss position at December 31, 2017, comprised both investment grade and below investment grade securities for which fair value declined primarily due to widening credit spreads since the date of purchase.

The following tables present, for all securities in an unrealized loss position at December 31, 2017, and December 31, 2016 (including securities on loan), the aggregate fair value and gross unrealized loss by length of time the security has continuously been in an unrealized loss position.

(in thousands of U.S. dollars)	2017					
	0 - 12 Months		Over 12 Months		Total	
	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss
U.S. Treasury and agency	\$ 348,979	(2,174)	95,775	(2,746)	444,754	(4,920)
Foreign bonds	652,184	(10,696)	349,440	(15,347)	1,001,624	(26,043)
Corporate securities	514,677	(6,553)	205,224	(8,774)	719,901	(15,327)
Mortgage-backed securities	762,540	(5,798)	520,334	(11,693)	1,282,874	(17,491)
States, municipalities, and political subdivisions	16,028	(88)	44,031	(2,198)	60,059	(2,286)
Total fixed maturities	<u>2,294,408</u>	<u>(25,309)</u>	<u>1,214,804</u>	<u>(40,758)</u>	<u>3,509,212</u>	<u>(66,067)</u>
Equity Securities	142	(81)	-	-	142	(81)
Other Investments	70,303	(3,862)	-	-	70,303	(3,862)
<b>Total</b>	<b><u>\$ 2,364,853</u></b>	<b><u>(29,252)</u></b>	<b><u>1,214,804</u></b>	<b><u>(40,758)</u></b>	<b><u>3,579,657</u></b>	<b><u>(70,010)</u></b>

**Chubb Tempest Reinsurance Ltd. and its subsidiaries**  
**Notes to Consolidated Financial Statements**  
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	2016					
	0 - 12 Months		Over 12 Months		Total	
	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss
U.S. Treasury and agency \$	512,567	(8,580)	-	-	512,567	(8,580)
Foreign bonds	576,717	(15,129)	104,461	(7,639)	681,178	(22,768)
Corporate securities	661,498	(13,133)	167,819	(12,406)	829,317	(25,539)
Mortgage-backed securities	1,224,166	(19,686)	13,385	(320)	1,237,551	(20,006)
States, municipalities, and political subdivisions	74,798	(2,687)	17,232	(817)	92,030	(3,504)
Total fixed maturities	<u>3,049,746</u>	<u>(59,215)</u>	<u>302,897</u>	<u>(21,182)</u>	<u>3,352,643</u>	<u>(80,397)</u>
Equity Securities	1,030	(473)	-	-	1,030	(473)
Other Investments	<u>130,344</u>	<u>(7,340)</u>	<u>-</u>	<u>-</u>	<u>130,344</u>	<u>(7,340)</u>
<b>Total</b>	<b>\$ 3,181,120</b>	<b>(67,028)</b>	<b>302,897</b>	<b>(21,182)</b>	<b>3,484,017</b>	<b>(88,210)</b>

**(f) Net investment income**

The following table presents the source of net investment income for the years ended December 31, 2017 and 2016.

(in thousands of U.S. dollars)	2017	2016
Fixed maturities	\$457,869	\$440,762
Short-term investments	5,777	2,821
Equity securities	164	75
Other investments	89,762	54,924
Investment income from affiliates	<u>6,387</u>	<u>5,775</u>
Gross investment income	559,959	504,357
Investment expenses	(8,485)	(18,135)
<b>Net investment income</b>	<b>\$551,474</b>	<b>\$486,222</b>

**(g) Restricted Assets**

The Company is required to maintain assets on deposit with various regulatory authorities to support its reinsurance operations. These requirements are generally promulgated in the statutory regulations of the individual jurisdictions. The assets on deposit are available to settle reinsurance liabilities. The Company is required to restrict assets pledged under reverse repurchase agreements. The Company also utilizes trust funds in certain transactions where the trust funds are set up for the benefit of the ceding companies and generally take the place of Letter of Credit ("LOC") requirements. The Company also has investments in segregated portfolios primarily to provide collateral or guarantees for LOCs and derivative transactions. Included in restricted assets at December 31, 2017 and 2016, are fixed maturities totaling \$6,614.5 million and \$6,340.5 million and cash of \$5.2 million and \$8.1 million, respectively.

**Chubb Tempest Reinsurance Ltd. and its subsidiaries**  
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The following table presents the components of the restricted assets at December 31, 2017 and 2016.

(in thousands of U.S. dollars)	2017	2016
Deposits with non-U.S. regulatory authorities	\$6,239	\$6,000
Trust funds	6,041,216	5,773,129
Assets pledged under repurchase agreements	572,274	569,495
	<hr/>	<hr/>
	\$6,619,729	\$6,348,624

In addition, the Company also utilizes a floating charge over certain assets for the benefit of a ceding company. Under the agreement, the Company would be required to secure assets in a trust for the benefit of the ceding company upon certain triggering events, including a rating downgrade below "A" by Standard and Poor's. Although there have been no triggering events, in 2015 the Company elected to fund a trust for the benefit of the ceding company with a balance at December 31, 2017 and 2016 of \$823.0 million and \$847.8 million, respectively, and therefore the maximum amount of the floating charge as at December 31, 2017 and 2016 is \$nil.

**5. *Unpaid losses and loss expenses***

The Company establishes reserves for the estimated unpaid ultimate liability for losses and loss expenses under the terms of its policies and agreements. Reserves include estimates for both claims that have been reported and for IBNR claims, and include estimates of expenses associated with processing and settling these claims. Reserves are recorded in Unpaid losses and loss expenses in the consolidated balance sheets. While we believe that our reserves for unpaid losses and loss expenses at December 31, 2017 are adequate, new information or trends may lead to future developments in incurred losses and loss expenses significantly greater or less than the reserves provided. Any such revisions could result in future changes in estimates of losses or reinsurance recoverable and would be reflected in our results of operations in the period in which the estimates are changed.

# Chubb Tempest Reinsurance Ltd. and its subsidiaries

## Notes to Consolidated Financial Statements

### For the years ended December 31, 2017 and 2016

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The following table presents a reconciliation of unpaid losses and loss expenses for the years ended December 31, 2017 and 2016.

(in thousands of U.S. dollars)	<b>2017</b>	<b>2016</b>
Gross unpaid losses and loss expenses at beginning of year	\$ 6,256,213	\$ 6,222,762
Reinsurance recoverable <sup>(1)</sup>	<u>(716,496)</u>	<u>(693,701)</u>
Net unpaid losses and loss expenses at beginning of year	<u>5,539,717</u>	<u>5,529,061</u>
Net losses and loss expenses incurred in respect of losses occurring in:		
Current year	2,957,357	2,182,163
Prior years <sup>(2)</sup>	<u>(100,786)</u>	<u>(200,890)</u>
Total	<u>2,856,571</u>	<u>1,981,273</u>
Net losses and loss expenses paid in respect of losses occurring in:		
Current year	(954,870)	(697,770)
Prior years	<u>(1,406,729)</u>	<u>(1,215,472)</u>
Total	<u>(2,361,599)</u>	<u>(1,913,242)</u>
Foreign currency revaluation and other	<u>82,324</u>	<u>(57,375)</u>
Net unpaid losses and loss expenses at end of year	6,117,013	5,539,717
Reinsurance recoverable <sup>(1)</sup>	<u>1,061,478</u>	<u>716,496</u>
Gross unpaid losses and loss expenses at end of year	<u>\$ 7,178,491</u>	<u>\$ 6,256,213</u>

(1) Net of provision for uncollectible reinsurance  
 (2) Relates to prior period loss reserve development only and excludes prior period development related to reinstatement premiums, expense adjustments, and earned premiums.

The increase in gross and net unpaid losses and loss expenses in 2017 primarily reflects increased loss due to the 2017 catastrophes.

Net losses and loss expenses incurred includes \$100.8 million and \$201 million of net favorable prior period development in the years ended December 31, 2017 and 2016, respectively. These developments followed a detailed review by the actuaries and reflected lower reported claim development than previously anticipated.

Much of the business written or assumed by the Company is long-tailed in nature (e.g., Workers' Compensation and Professional Lines) and can exhibit a high degree of variability. Furthermore, many of the lines of business written by the Company have grown significantly over the past several years as compared to the volume of business written in the early- to mid-2000's. The nature of the business written coupled with the relative immaturity of the business can expose the reserves to a higher-than-normal degree of uncertainty and the ultimate losses may be materially different.

In 2017, \$41.4 million of net favorable prior period development (\$95 million of net favorable prior period development in 2016) was attributable to long-tailed business across a number of lines and accident years due to better than expected claims emergence and favorable claim settlements. In addition, there was favorable development of \$59.4 million (\$106 million of net favorable prior period development in 2016) in short-tailed lines primarily related to various accident years, due to lack of emergence of newly reported claims and favorable development on known claims.

# **Chubb Tempest Reinsurance Ltd. and its subsidiaries**

## **Notes to Consolidated Financial Statements**

### **For the years ended December 31, 2017 and 2016**

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The following table presents a reconciliation of the loss development tables to the liability for unpaid losses and loss expenses in the consolidated balance sheet as at December 31, 2017:

(in thousands of U.S. dollars)	2017
<i>Net unpaid loss and allocated loss adjustment expense:</i>	
North America P& C – Casualty	\$ 2,787,567
North America P& C – Non-Casualty	309,179
Overseas General P&C – Casualty	1,081,949
Overseas General P&C – Non-Casualty	795,345
Global Reinsurance – Casualty	584,826
Global Reinsurance – Non-Casualty	233,756
<i>Excluded from the loss development tables</i>	
Other <sup>(1)</sup>	20,113
Net unpaid loss and allocated loss adjustment expense	\$ 5,812,735
<i>Ceded unpaid loss and allocated loss adjustment expense:</i>	
North America P& C – Casualty	\$ -
North America P& C – Non-Casualty	(469)
Overseas General P&C – Casualty	247,385
Overseas General P&C – Non-Casualty	688,469
Global Reinsurance – Casualty	-
Global Reinsurance – Non-Casualty	128,016
Other <sup>(1)</sup>	7,713
Ceded unpaid loss and allocated loss adjustment expense	\$ 1,071,114
Unpaid loss and loss expense on other than short-duration contracts <sup>(2)</sup>	\$ 294,642
Unpaid unallocated loss adjustment expenses	-
Unpaid losses and loss expenses	\$ 7,178,491

<sup>(1)</sup> This is comprised of businesses not included in the loss development tables from various lines of businesses none of which are materially significant.

<sup>(2)</sup> Primarily includes the claims reserve of our international A&H business and Life Insurance segment reserves.

#### **(a) Description of Reserving Methodologies**

Our recorded reserves represent management's best estimate of the provision for unpaid claims as of the balance sheet date. Management's best estimate is developed after collaboration with actuarial, underwriting, claims, legal, and finance departments and culminates with the input of reserve committees. Each reserve committee includes the participation of the relevant parties from actuarial, finance, claims, and unit senior management and has the responsibility for finalizing, recommending and approving the estimate to be used as management's best estimate. Reserves are further reviewed by Chubb's Chief Actuary and senior management. The objective of such a process is to determine a single estimate that we believe represents a better estimate than any other and which is viewed by management to be the best estimate of ultimate loss settlements.

This estimate is based on a combination of exposure and experience-based actuarial methods (described below) and other considerations such as claims reviews, reinsurance recovery assumptions and/or input from other knowledgeable parties such as underwriting. Exposure-based methods are most commonly used on

# **Chubb Tempest Reinsurance Ltd. and its subsidiaries**

## **Notes to Consolidated Financial Statements**

### **For the years ended December 31, 2017 and 2016**

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relatively immature origin years (i.e., the year in which the losses were incurred — “accident year” or “report year”), while experience-based methods provide a view based on the projection of loss experience that has emerged as of the valuation date. Greater reliance is placed upon experience-based methods as the pool of emerging loss experience grows and where it is deemed sufficiently credible and reliable as the basis for the estimate. In comparing the held reserve for any given origin year to the actuarial projections, judgment is required as to the credibility, uncertainty and inherent limitations of applying actuarial techniques to historical data to project future loss experience. Examples of factors that impact such judgments include, but are not limited to, the following:

- nature and complexity of underlying coverage provided and net limits of exposure provided;
- segmentation of data to provide sufficient homogeneity and credibility for loss projection methods;
- extent of credible internal historical loss data and reliance upon industry information as required;
- historical variability of actual loss emergence compared with expected loss emergence;
- extent of emerged loss experience relative to the remaining expected period of loss emergence;
- rate monitor information for new and renewal business;
- facts and circumstances of large claims;
- impact of applicable reinsurance recoveries; and
- nature and extent of underlying assumptions.

We have actuarial staff who analyze loss reserves (including loss expenses) and regularly project estimates of ultimate losses and the corresponding indications of the required IBNR reserve. Our reserving approach is a comprehensive ground-up process using data at a detailed level that reflects the specific types and coverages of our diverse product offering. The data presented in this disclosure was prepared on a more aggregated basis and with a focus on changes in incurred loss estimates over time as well as associated cash flows. We note that data prepared on this basis may not demonstrate the full spectrum of characteristics that are evident in the more detailed level studied internally.

We perform an actuarial reserve review for each product line at least once a year. For most product lines, one or more standard actuarial reserving methods may be used to determine estimates of ultimate losses and loss expenses, and from these estimates, a single actuarial central estimate is selected. The actuarial central estimate is an input to the reserve committee process described above.

#### **(b) Standard actuarial reserving methods**

Standard actuarial reserving methods include, but are not limited to, expected loss ratio, paid and reported loss development, and Bornhuetter-Ferguson methods. A general description of these methods is provided below. In addition to these standard methods, depending upon the product line characteristics and available data, we may use other recognized actuarial methods and approaches. Implicit in the standard actuarial methods that we generally utilize is the need for two fundamental assumptions: first, the pattern by which losses are expected to emerge over time for each origin year, and second the expected loss ratio for each origin year.

The expected loss ratio for any particular origin year is selected after consideration of a number of factors, including historical loss ratios adjusted for rate changes, premium and loss trends, industry benchmarks, the results of policy level loss modeling at the time of underwriting, and/or other more subjective considerations for the product line (e.g., terms and conditions) and external environment as noted above. The expected loss ratio for a given origin year is initially established at the start of the origin year as part of the planning process. This analysis is performed in conjunction with underwriters and management. The expected loss ratio method arrives at an ultimate loss estimate by multiplying the expected ultimate loss ratio by the

# **Chubb Tempest Reinsurance Ltd. and its subsidiaries**

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corresponding premium base. This method is most commonly used as the basis for the actuarial central estimate for immature origin periods on product lines where the actual paid or reported loss experience is not yet deemed sufficiently credible to serve as the principal basis for the selection of ultimate losses. The expected loss ratio for a given origin year may be modified over time if the underlying assumptions differ from the original assumptions (e.g., the assessment of prior year loss ratios, loss trend, rate changes, actual claims, or other information).

Our selected paid and reported development patterns provide a benchmark against which the actual emerging loss experience can be monitored. Where possible, development patterns are selected based on historical loss emergence by origin year. For product lines where the historical data is viewed to have low statistical credibility, the selected development patterns also reflect relevant industry benchmarks and/or experience from similar product lines written elsewhere within Chubb. This most commonly occurs for relatively new product lines that have limited historical data or for high severity/low frequency portfolios where our historical experience exhibits considerable volatility and/or lacks credibility. The paid and reported loss development methods convert the selected loss emergence pattern to a set of multiplicative factors which are then applied to actual paid or reported losses to arrive at an estimate of ultimate losses for each period. Due to their multiplicative nature, the paid and reported loss development methods will leverage differences between actual and expected loss emergence. These methods tend to be utilized for more mature origin periods and for those portfolios where the loss emergence has been relatively consistent over time.

The Bornhuetter-Ferguson method is a combination of the expected loss ratio method and the loss development method, where the loss development method is given more weight as the origin year matures. This approach allows a logical transition between the expected loss ratio method which is generally utilized at earlier maturities and the loss development methods which are typically utilized at later maturities. We usually apply this method using reported loss data although paid data may also be used.

#### ***Short-tail business***

Short-tail business generally describes product lines for which losses are typically known and paid shortly after the loss actually occurs. This would include, for example, most property, personal accident, and automobile physical damage policies that we write. Due to the short reporting and development pattern for these product lines, the uncertainty associated with our estimate of ultimate losses for any particular accident period diminishes relatively quickly as actual loss experience emerges. We typically assign credibility to methods that incorporate actual loss emergence, such as the paid and reported loss development and Bornhuetter-Ferguson methods, sooner than would be the case for long-tail lines at a similar stage of development for a given origin year. The reserving process for short-tail losses arising from catastrophic events typically involves an assessment by the claims department, in conjunction with underwriters and actuaries, of our exposure and estimated losses immediately following an event and then subsequent revisions of the estimated losses as our insureds provide updated actual loss information.

#### ***Long-tail business***

Long-tail business describes lines of business for which specific losses may not be known/reported for some period and for which claims can take significant time to settle/close. This includes most casualty lines such as general liability, D&O, and workers' compensation. There are various factors contributing to the uncertainty and volatility of long-tail business. Among these are:

- The nature and complexity of underlying coverage provided and net limits of exposure provided;
- Our historical loss data and experience is sometimes too immature and lacking in credibility to rely upon for reserving purposes. Where this is the case, in our reserve analysis we may utilize industry loss ratios or industry benchmark development patterns that we believe reflect the nature and coverage of the underwritten business and its future development, where available. For such product lines, actual loss experience may differ from industry loss statistics as well as loss experience for previous underwriting years;

# **Chubb Tempest Reinsurance Ltd. and its subsidiaries**

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### **For the years ended December 31, 2017 and 2016**

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- The difficulty in estimating loss trends, claims inflation (e.g., medical and judicial) and underlying economic conditions;
- The need for professional judgment to estimate loss development patterns beyond that represented by historical data using supplemental internal or industry data, extrapolation, or a blend of both;
- The need to address shifts in mix over time when applying historical paid and reported loss development patterns from older origin years to more recent origin years. For example, changes over time in the processes and procedures for establishing case reserves can distort reported loss development patterns or changes in ceded reinsurance structures by origin year can alter the development of paid and reported losses;
- Loss reserve analyses typically require loss or other data be grouped by common characteristics in some manner. If data from two combined lines of business exhibit different characteristics, such as loss payment patterns, the credibility of the reserve estimate could be affected. Additionally, since casualty lines of business can have significant intricacies in the terms and conditions afforded to the insured, there is an inherent risk as to the homogeneity of the underlying data used in performing reserve analyses; and
- The applicability of the price change data used to estimate ultimate loss ratios for most recent origin years.

As described above, various factors are considered when determining appropriate data, assumptions, and methods used to establish the loss reserve estimates for long-tail product lines. These factors may also vary by origin year for given product lines. The derivation of loss development patterns from data and the selection of a tail factor to project ultimate losses from actual loss emergence require considerable judgment, particularly with respect to the extent to which historical loss experience is relied upon to support changes in key reserving assumptions.

#### **(c) Loss Development Tables**

The tables were designed to present business with similar risk characteristics which exhibit like development patterns and generally similar trends, in order to provide insight into the nature, amount, timing and uncertainty of cash flows related to our claims liabilities.

Each table follows a similar format and reflects the following:

- The incurred loss triangle includes both reported case reserves and IBNR liabilities.
- Both the incurred and paid loss triangles include allocated loss adjustment expense (i.e., defense and investigative costs particular to individual claims) but exclude unallocated loss adjustment expense (i.e., the costs associated with internal claims staff and third party administrators).
- The amounts in both triangles for the years ended December 31, 2008, to December 31, 2016 and average historical claim duration as of December 31, 2017, are presented as supplementary information.
- All data presented in the triangles is net of reinsurance recoverables.
- The IBNR reserves shown to the right of each incurred loss development exhibit reflect the net IBNR recorded as of December 31, 2017.

Historical dollar amounts are presented in this footnote on a constant-currency basis, which is achieved by assuming constant foreign exchange rates for all periods in the loss triangles, translating prior period amounts using the same local currency exchange rates as the current year end. The impact of this conversion is to show the change between periods exclusive of the effect of fluctuations in exchange rates, which would otherwise distort the change in incurred loss and cash flow patterns shown. The change in incurred loss

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shown will differ from other U.S. GAAP disclosures of incurred prior period reserve development amounts, which include the effect of fluctuations in exchange rates.

We provided guidance above on key assumptions that should be considered when reviewing this disclosure and information relating to how loss reserve estimates are developed. We believe the information provided in the “Loss Development Tables” section of the disclosure is of limited use for independent analysis or application of standard actuarial estimations.

#### **North America P&C - Casualty - Long-tail**

This product line is comprised of various long-tail lines of business including Workers Compensation, Liability, and Other Casualty coverages.

Workers Compensation has a substantial geographic spread and a broad mix across industries. Types of coverage include risk management business predominantly with high deductible policies, loss sensitive business (i.e., retrospectively-rated policies), business fronted for captives, as well as excess and primary guaranteed cost coverages.

Liability consists of primary and excess liability exposures, including medical liability, and professional lines, including directors and officers (D&O) liability, errors and omissions (E&O) liability, employment practices liability (EPL), fidelity bonds, and fiduciary liability. This line also consists of automobile liability, marine, and aviation.

The primary and excess liability business represents the largest part of these exposures. The former includes both monoline and commercial package liability. The latter includes a substantial proportion of commercial umbrella, excess and high excess business, where loss activity can produce significant volatility in the loss triangles at later ages within an accident year (and sometimes across years) due to the size of the limits afforded and the complex nature of the underlying losses.

This line includes management and professional liability products provided to a wide variety of clients, from national accounts to small firms along with private and not-for-profit organizations, distributed through brokers, agents, wholesalers and MGAs. Many of these coverages, particularly D&O and E&O, are typically written on a claims-made form. While most of the coverages are underwritten on a primary basis, there are significant amounts of large line and excess exposure as well.

Other Casualty consists of the remaining commercial casualty coverages such as automobile liability and aviation. There is also a small portion of commercial multi-peril (CMP) business in accident years 2014 and prior. The paid and reported data are impacted by some catastrophe loss activity primarily on the CMP exposures just noted.

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**Net Incurred Loss and Allocated Loss Adjustment Expenses as at**

(in thousands of U.S. dollars)

Years ended December 31

Accident Year	Audited										Net IBNR reserves
	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	
2008	\$ 748,056	\$ 738,580	\$ 743,506	\$ 751,094	\$ 740,574	\$ 667,581	\$ 669,975	\$ 660,486	\$ 662,875	\$ 651,063	\$ 72,502
2009		495,077	496,355	492,491	493,958	483,081	414,991	408,701	407,238	405,249	54,359
2010			468,430	457,428	460,849	464,869	463,125	433,161	423,408	434,603	72,542
2011				441,159	429,342	433,956	437,511	435,995	427,545	429,679	92,604
2012					444,771	451,816	465,841	469,756	465,435	456,817	81,127
2013						537,459	537,239	549,012	548,098	525,740	152,694
2014							450,055	456,759	471,530	480,105	187,729
2015								492,375	500,506	518,537	234,148
2016									550,119	557,234	340,266
2017										578,905	457,184
Total											\$ 5,037,932

**Net Cumulative Paid Loss and Allocated Loss Adjustment Expenses as at**

(in thousands of U.S. dollars)

Years ended December 31

Accident Year	Audited									
	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
2008	\$ 32,020	\$ 99,358	\$ 189,014	\$ 282,490	\$ 352,720	\$ 410,892	\$ 468,914	\$ 504,085	\$ 533,199	\$ 544,680
2009		30,139	81,651	126,054	174,245	207,762	258,081	284,648	314,005	320,150
2010			48,997	103,129	157,191	200,764	242,446	285,832	307,702	322,286
2011				58,232	112,561	158,056	208,256	251,062	284,092	300,077
2012					52,650	126,055	181,824	241,492	298,534	332,377
2013						49,876	125,498	205,579	264,063	319,122
2014							50,313	117,992	187,063	245,256
2015								59,798	143,405	219,250
2016									64,051	156,160
2017										76,599
Total										\$ 2,835,957

**Net Liabilities for Loss and Allocated Loss Adjustment Expenses as at December 31, 2017**

(in thousands of U.S. dollars)

2017

Accident years prior to 2008

\$ 585,592

All Accident years

\$ 2,787,567

**Chubb Tempest Reinsurance Ltd. and its subsidiaries**  
**Notes to Consolidated Financial Statements**  
**For the years ended December 31, 2017 and 2016**

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**Supplementary Information: Average Annual Percentage Payout of Net Incurred Claims by Age, as at December 31, 2017**

Age in Years	1	2	3	4	5	6	7	8	9	10
Percentage	10%	14%	13%	12%	10%	9%	6%	5%	3%	2%

**North America P&C – Non-Casualty - Short-tail**

This product line represents first party personal and commercial product lines that are short-tailed in nature. Chubb provides personal lines coverage for high-net-worth individuals and families in North America including homeowners, automobile, valuable articles (including fine art), umbrella liability, and recreational marine insurance offered through independent regional agents and brokers. Commercial include a wide diversity of products including property, inland marine, ocean marine, surety, and A&H on both a primary and excess basis, and various policy sizes. Some years may be impacted by natural catastrophe losses.

**Net Incurred Loss and Allocated Loss Adjustment Expenses as at**

(in thousands of U.S. dollars)

Years ended December 31

Accident Year	Audited										Net IBNR reserves
	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	
2008	\$ 232,296	\$ 253,408	\$ 252,374	\$ 252,244	\$ 251,220	\$ 249,328	\$ 246,499	\$ 246,039	\$ 245,585	\$ 245,062	\$ 685
2009		180,287	167,212	159,390	157,002	155,516	155,033	154,472	154,708	154,427	554
2010			182,762	190,058	187,051	182,014	180,861	181,164	178,461	177,709	608
2011				480,655	480,365	475,021	472,563	471,676	470,027	470,985	1,421
2012					552,681	533,904	524,728	522,661	523,839	522,854	3,190
2013						518,609	533,161	521,511	520,859	522,368	7,125
2014							354,304	347,592	339,562	335,805	4,897
2015								343,849	325,612	309,955	7,314
2016									283,245	278,196	30,823
2017										374,824	137,636
Total											\$ 3,392,185

**Chubb Tempest Reinsurance Ltd. and its subsidiaries**  
**Notes to Consolidated Financial Statements**  
**For the years ended December 31, 2017 and 2016**

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**Net Cumulative Paid Loss and Allocated Loss Adjustment Expenses as at**

(in thousands of U.S. dollars)	Years ended December 31										Audited
Accident Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	
2008	\$ 108,840	\$ 214,435	\$ 229,945	\$ 238,062	\$ 239,431	\$ 239,851	\$ 241,531	\$ 241,882	\$ 242,372	\$ 243,202	
2009		83,570	132,696	145,239	148,953	151,429	152,426	152,874	153,527	153,606	
2010			100,069	159,288	168,731	172,776	174,917	177,972	177,751	177,960	
2011				330,346	440,676	457,836	464,848	465,675	467,166	467,704	
2012					391,840	491,673	504,867	511,778	517,293	517,609	
2013						334,969	489,364	503,802	510,696	513,067	
2014							192,706	309,128	324,335	329,145	
2015								186,709	278,356	294,872	
2016									134,829	222,466	
2017										163,375	
Total											<u>\$ 3,083,006</u>

**Net Liabilities for Loss and Allocated Loss Adjustment Expenses as at December 31, 2017**

(in thousands of U.S. dollars)	2017
Accident years prior to 2008	\$ -
All Accident years	<u>\$ 309,179</u>

**Supplementary Information: Average Annual Percentage Payout of Net Incurred Claims by Age, as at December 31, 2017**

Age in Years	1	2	3	4	5	6	7	8	9	10
Percentage	60%	29%	4%	2%	1%	0%	0%	0%	0%	0%

**Overseas General –Casualty - Long-tail**

This product line is comprised of D&O liability, E&O liability, financial institutions (including crime/fidelity coverages), and non-U.S. general liability as well as aviation and political risk. Exposures are located around the world, including Europe, Latin America, and Asia.

There is some U.S. exposure in Casualty from multinational accounts. The financial lines coverages are typically written on a claims-made form, while general liability coverages are typically on an occurrence basis and include a mix of primary and excess business.

**Chubb Tempest Reinsurance Ltd. and its subsidiaries**  
**Notes to Consolidated Financial Statements**  
**For the years ended December 31, 2017 and 2016**

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**Net Incurred Loss and Allocated Loss Adjustment Expenses as at**

(in thousands of U.S. dollars)

Years ended December 31

	Audited										Net IBNR reserves
Accident Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2017
2008	\$ 154,053	\$ 177,163	\$ 197,022	\$ 201,565	\$ 196,027	\$ 196,212	\$ 189,124	\$ 191,331	\$ 189,620	\$ 185,410	\$ 9,401
2009		132,828	149,750	164,515	172,175	164,889	144,432	137,732	148,023	144,219	19,687
2010			139,143	173,608	170,555	176,221	165,722	157,719	152,678	153,311	9,152
2011				155,659	161,777	158,538	168,460	160,093	150,256	157,351	36,242
2012					164,317	182,441	199,430	210,319	219,454	231,244	37,895
2013						154,277	175,229	171,675	156,272	141,390	30,216
2014							164,565	164,755	185,188	188,740	67,072
2015								175,767	157,671	160,424	49,187
2016									179,420	157,138	83,627
2017										323,340	277,882
Total											\$ 1,842,567

**Net Cumulative Paid Loss and Allocated Loss Adjustment Expenses as at**

(in thousands of U.S. dollars)

Years ended December 31

	Audited									
Accident Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
2008	\$ 6,623	\$ 18,571	\$ 23,252	\$ 46,498	\$ 64,884	\$ 78,475	\$ 90,176	\$ 109,448	\$ 133,344	\$ 145,936
2009		6,717	20,843	40,254	58,701	61,909	67,367	78,794	86,883	96,563
2010			6,362	16,737	42,535	58,330	75,017	85,092	98,076	107,991
2011				9,433	20,061	24,065	44,282	48,847	59,872	82,109
2012					11,649	36,471	53,051	76,590	86,579	141,654
2013						11,667	31,760	53,926	67,630	81,580
2014							11,463	28,728	50,173	69,685
2015								7,167	22,908	52,530
2016									18,841	42,196
2017										15,168
Total										\$ 835,412

**Net Liabilities for Loss and Allocated Loss Adjustment Expenses as at December 31, 2017**

(in thousands of U.S. dollars)

		2017
Accident years prior to 2008		\$ 74,794
All Accident years		<u>\$ 1,081,949</u>

**Chubb Tempest Reinsurance Ltd. and its subsidiaries**  
**Notes to Consolidated Financial Statements**  
**For the years ended December 31, 2017 and 2016**

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**Supplementary Information: Average Annual Percentage Payout of Net Incurred Claims by Age, as at December 31, 2017**

Age in Years	1	2	3	4	5	6	7	8	9	10
Percentage	6%	10%	11%	11%	7%	11%	9%	8%	10%	7%

**Overseas General – Non-Casualty - Short-tail**

This product line is comprised of commercial fire, marine (predominantly cargo), surety, personal automobile, personal cell phones, personal residential (including high net worth), energy and construction. In general, these lines have relatively stable payment and reporting patterns although some years may be impacted by natural catastrophes.

**Net Incurred Loss and Allocated Loss Adjustment Expenses as at**

(in thousands of U.S. dollars)

Years ended December 31

Audited      Net IBNR reserves

Accident Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2017
2008	\$ 235,917	\$ 210,794	\$ 204,371	\$ 203,211	\$ 196,002	\$ 189,145	\$ 189,050	\$ 187,773	\$ 185,888	\$ 185,406	\$ 543
2009		297,628	218,026	202,416	207,388	201,165	201,448	201,223	199,587	199,460	701
2010			290,595	303,781	288,292	303,117	314,978	315,725	312,975	297,758	1,308
2011				405,196	424,854	392,473	389,744	398,309	398,293	401,668	2,234
2012					274,916	265,025	260,584	252,022	246,334	240,133	1,757
2013						312,351	303,347	281,443	274,833	260,884	2,671
2014							334,775	360,534	327,321	310,929	4,542
2015								407,968	376,753	350,653	7,562
2016									541,683	580,957	12,179
2017										781,519	230,743
Total											\$ 3,609,367

**Net Cumulative Paid Loss and Allocated Loss Adjustment Expenses as at**

(in thousands of U.S. dollars)

Years ended December 31

Audited

Accident Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
2008	\$ 67,339	\$ 146,117	\$ 162,131	\$ 187,061	\$ 193,115	\$ 190,438	\$ 188,533	\$ 188,900	\$ 189,225	\$ 187,758
2009		72,537	148,101	171,938	192,578	195,819	197,326	196,865	196,479	196,170
2010			100,911	204,333	235,183	260,185	273,335	273,976	274,303	274,505
2011				140,599	306,349	341,343	351,862	362,881	360,641	363,312
2012					84,040	186,783	222,365	233,544	235,635	236,064
2013						77,655	184,214	238,989	238,643	245,037
2014							83,328	232,326	290,663	298,893
2015								111,032	252,092	327,709
2016									218,338	425,789
2017										268,498
Total										\$ 2,823,735

# **Chubb Tempest Reinsurance Ltd. and its subsidiaries**

## **Notes to Consolidated Financial Statements**

### **For the years ended December 31, 2017 and 2016**

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#### **Net Liabilities for Loss and Allocated Loss Adjustment Expenses as at December 31, 2017**

(in thousands of U.S. dollars)	2017
Accident years prior to 2008	\$ 9,713
All Accident years	\$ 795,345

#### **Supplementary Information: Average Annual Percentage Payout of Net Incurred Claims by Age, as at December 31, 2017**

Age in Years	1	2	3	4	5	6	7	8	9	10
Percentage	34%	40%	15%	5%	3%	0%	0%	0%	0%	-1%

#### **Global Reinsurance**

Global reinsurance analyzes its business on a treaty year basis rather than on an accident year basis. Treaty year data was converted to an accident year basis for the purposes of this disclosure. Mix shifts are an important consideration in these product line groupings. As proportional business and excess of loss business have different earning and loss reporting and payment patterns, this change in mix will affect the cash flow patterns across the accident years. In addition, the shift from excess to proportional business over time will make the cash flow patterns of older and more recent years difficult to compare. In general, the proportional business will pay out more quickly than the excess of loss business, as such, using older years development patterns may overstate the ultimate loss estimates in more recent years.

#### **Global Reinsurance - Casualty - Long-tail**

This product line includes proportional and excess coverages in general, automobile liability, professional liability, medical malpractice, workers' compensation and aviation, with exposures located around the world. In general, reinsurance exhibits less stable development patterns than primary business. In particular general casualty reinsurance and excess coverages are long-tailed and can be very volatile.

#### **Net Incurred Loss and Allocated Loss Adjustment Expenses as at**

(in thousands of U.S. dollars)	Years ended December 31										Net IBNR reserves
Accident Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Audited
2008	\$ 174,725	\$ 183,195	\$ 198,322	\$ 195,815	\$ 192,293	\$ 180,939	\$ 178,186	\$ 179,371	\$ 177,914	\$ 178,356	\$ 22,886
2009		106,604	108,777	113,901	112,076	111,984	107,330	104,788	102,363	105,244	4,232
2010			93,653	98,266	94,479	94,274	89,959	84,938	80,130	79,479	14,648
2011				95,831	93,615	92,220	90,534	86,432	78,611	78,239	9,689
2012					79,537	73,301	73,552	73,792	69,035	58,011	4,995
2013						63,277	61,919	61,766	60,126	61,578	12,051
2014							67,552	62,315	62,105	64,767	12,895
2015								70,373	68,766	70,452	11,049
2016									82,453	85,746	28,290
2017										92,673	56,092
Total										\$ 874,545	

**Chubb Tempest Reinsurance Ltd. and its subsidiaries**  
**Notes to Consolidated Financial Statements**  
**For the years ended December 31, 2017 and 2016**

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**Net Cumulative Paid Loss and Allocated Loss Adjustment Expenses as at**

(in thousands of U.S. dollars)

Years ended December 31

Audited

Accident Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
2008	\$ 15,702	\$ 32,463	\$ 53,902	\$ 73,337	\$ 89,527	\$ 104,720	\$ 116,710	\$ 124,621	\$ 129,038	\$ 135,037
2009		12,693	21,566	31,456	41,195	51,985	60,251	67,472	72,944	78,959
2010			7,709	12,942	18,993	26,184	33,149	38,935	43,408	48,962
2011				8,714	12,447	16,558	22,644	28,768	33,819	40,945
2012					9,957	16,973	21,993	27,314	34,491	35,483
2013						8,841	14,293	18,540	24,101	29,404
2014							9,965	18,764	24,746	30,290
2015								12,818	20,560	28,779
2016									14,374	29,168
2017										16,146
Total										\$ 473,173

**Net Liabilities for Loss and Allocated Loss Adjustment Expenses as at December 31, 2017**

(in thousands of U.S. dollars)

2017

Accident years prior to 2008

\$ 183,454

All Accident years

\$ 584,826

**Supplementary Information: Average Annual Percentage Payout of Net Incurred Claims by Age, as at December 31, 2017**

Age in Years	1	2	3	4	5	6	7	8	9	10
Percentage	13%	10%	9%	9%	9%	7%	7%	5%	4%	3%

**Global Reinsurance – Non-Casualty - Short-tail**

This product line includes property, property catastrophe, marine, credit/surety, A&H and energy and some years may be impacted by natural catastrophes.

**Chubb Tempest Reinsurance Ltd. and its subsidiaries**  
**Notes to Consolidated Financial Statements**  
**For the years ended December 31, 2017 and 2016**

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**Net Incurred Loss and Allocated Loss Adjustment Expenses as at**

(in thousands of U.S. dollars)	Years ended December 31										Audited	Net IBNR reserves
	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017		
Accident Year												
2008	\$ 235,205	\$ 228,291	\$ 225,253	\$ 222,364	\$ 220,073	\$ 219,204	\$ 218,198	\$ 216,432	\$ 216,514	\$ 217,472	\$ 1,345	
2009		62,858	77,633	65,590	62,625	59,700	57,526	56,841	56,915	57,952	984	
2010			109,622	129,000	124,737	125,503	127,905	127,621	127,934	127,674	3,577	
2011				176,927	183,639	180,764	175,982	176,042	176,188	176,594	54	
2012					102,070	97,677	92,023	86,101	83,561	81,382	2,703	
2013						66,981	60,153	57,545	55,786	55,983	2,845	
2014							63,290	64,252	66,914	68,048	4,774	
2015								44,970	43,946	46,068	2,033	
2016									107,884	104,632	11,823	
2017										303,533	43,285	
Total											\$ 1,239,338	

**Net Cumulative Paid Loss and Allocated Loss Adjustment Expenses as at**

(in thousands of U.S. dollars)	Years ended December 31										Audited
	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	
Accident Year											
2008	\$ 63,432	\$ 137,082	\$ 173,396	\$ 202,187	\$ 212,840	\$ 214,305	\$ 214,873	\$ 215,242	\$ 215,700	\$ 215,089	
2009		16,973	39,487	48,839	52,459	53,762	54,826	55,109	55,204	54,828	
2010			16,706	89,845	106,276	113,758	115,477	121,682	121,353	123,934	
2011				55,352	112,017	132,112	152,669	167,253	169,804	172,004	
2012					19,201	51,357	65,096	70,884	73,234	76,303	
2013						12,530	34,821	44,153	48,853	49,721	
2014							19,529	41,823	53,232	59,207	
2015								12,560	27,451	36,463	
2016									23,306	68,220	
2017										159,513	
Total											\$ 1,015,282

**Net Liabilities for Loss and Allocated Loss Adjustment Expenses as at December 31, 2017**

(in thousands of U.S. dollars)	2017
Accident years prior to 2008	\$ 9,700
All Accident years	\$ 233,756

**Chubb Tempest Reinsurance Ltd. and its subsidiaries**  
**Notes to Consolidated Financial Statements**  
**For the years ended December 31, 2017 and 2016**

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**Supplementary Information: Average Annual Percentage Payout of Net Incurred Claims by Age, as at December 31, 2017**

Age in Years	1	2	3	4	5	6	7	8	9	10
Percentage	32%	39%	15%	10%	4%	2%	0%	1%	0%	0%

**6. Reinsurance**

The Company purchases reinsurance to manage various exposures including catastrophic risks. Although reinsurance agreements contractually obligate the Company's reinsurers to reimburse it for the agreed upon portion of its gross paid losses, they do not discharge the primary liability of the Company. The amounts for net premiums written and net premiums earned in the consolidated statements of operations are net of reinsurance.

The following table presents assumed, and ceded premiums for the years ended December 31, 2017 and 2016.

(in thousands of U.S. dollars)	<b>2017</b>	<b>2016</b>
Premiums written		
Assumed	\$ 4,944,836	\$ 4,461,512
Ceded	<u>(416,263)</u>	<u>(331,214)</u>
Net	<u>4,528,573</u>	<u>4,130,298</u>
Premiums earned		
Assumed	4,833,603	4,353,052
Ceded	<u>(408,575)</u>	<u>(329,022)</u>
Net	<u>\$ 4,425,028</u>	<u>\$ 4,024,030</u>

The following table presents the composition of the Company's reinsurance recoverable on losses and loss expenses at December 31, 2017 and 2016.

(in thousands of U.S. dollars)	<b>2017</b>	<b>2016</b>
Reinsurance recoverable on paid losses and loss expenses, net of a provision for uncollectible reinsurance	\$ 50,277	\$ 34,932
Reinsurance recoverable on unpaid losses and loss expenses, net of a provision for uncollectible reinsurance	1,061,478	716,496
Reinsurance recoverable on future policy benefit	666	-
Net reinsurance recoverable	<u>\$ 1,112,421</u>	<u>\$ 751,428</u>

The Company evaluates the financial condition of its reinsurers and potential reinsurers on a regular basis and also monitors concentrations of credit risk with reinsurers. The provision for uncollectible reinsurance is required principally due to the potential failure of reinsurers to indemnify the Company, primarily because of disputes under reinsurance contracts and insolvencies. Provisions have been established for amounts estimated to be uncollectible. At December 31, 2017 and 2016, the Company recorded a provision for uncollectible reinsurance of \$12.7 million and \$11.7 million, respectively.

# **Chubb Tempest Reinsurance Ltd. and its subsidiaries**

## **Notes to Consolidated Financial Statements**

### **For the years ended December 31, 2017 and 2016**

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The following tables present a listing, at December 31, 2017 and 2016, of the categories of the Company's reinsurers. The first category, largest reinsurers, represents all reinsurers where the gross recoverable exceeds one percent of the Company's total shareholder's equity. The provision for uncollectible reinsurance is principally based on an analysis of the credit quality of the reinsurer and collateral balances.

(in thousands of U.S. dollars)	<b>2017</b>	<b>2016</b>
Largest reinsurers	\$ 460,014	\$ 253,338
Other reinsurers balances rated A- or better	558,690	477,886
Other reinsurers with ratings lower than A-	93,717	20,204
<b>Total</b>	<b>\$ 1,112,421</b>	<b>\$ 751,428</b>

#### **Largest Reinsurers**

Alleghany Corporation  
 HDI Haftpflichtverband Der Deutschen Industrie VAG (Hannover)  
 Munich Re Group  
 Swiss Re Group  
 XL Catlin Group

#### **7. Related party business**

The Company reinsures a number of affiliates for property, casualty, marine, accident and health risks. Also, the company cedes or has ceded certain business to affiliates, including CTR. The business has been ceded on an excess of loss and a quota share basis.

The related statement of operations and balance sheet account balances for the years ended December 31, 2017 and 2016 have been affected by these intercompany reinsurance agreements as follows:

(in thousands of U.S. dollars)	<b>2017</b>	<b>2016</b>
Gross premiums written	\$4,665,813	\$4,193,591
Reinsurance premiums ceded	(28,691)	(26,304)
Net premiums earned	4,195,136	3,806,814
Losses and loss expenses	2,587,181	1,926,458
Future policy benefits	(9,171)	14,643
Policy acquisition costs	1,392,240	1,235,210
Reinsurance balances receivable	787,287	715,241
Prepaid reinsurance premiums	7,486	5,905
Reinsurance recoverable	9,170	12,664
Deferred policy acquisition costs	478,876	342,715
Value of reinsurance business assumed	183,684	199,237
Unpaid losses and loss expenses	6,907,011	6,175,207
Future policy benefits	897,652	912,429
Unearned premiums	1,410,635	1,234,916
Reinsurance balances payable	330,130	280,336

# Chubb Tempest Reinsurance Ltd. and its subsidiaries

## Notes to Consolidated Financial Statements

### For the years ended December 31, 2017 and 2016

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There are amounts due from related parties of \$371.0 million and \$293.1 million and due to related parties of \$36.0 million and \$33.4 million as at December 31, 2017 and 2016, respectively. Included in amounts due from related parties at December 31, 2017 and 2016, is a net receivable from our parent company of \$267.1 million and \$236.4 million, respectively. The non-controlling interest in Oasis Investments is held by a related party.

#### **8. Commitments, contingencies and guarantees**

##### **(a) Derivative Instruments**

The Company maintains positions in derivative instruments such as futures, options, and foreign currency forward contracts for which the primary purposes are to manage duration and foreign currency exposure, yield enhancement, or to obtain an exposure to a particular financial market. The Company also maintains positions in convertible securities that contain embedded derivatives. Investment derivative instruments are recorded in either Other assets (OA) or Accounts payable, accrued expenses, and other liabilities (AP), convertible bonds are recorded in Fixed maturities available for sale (FM AFS) and convertible equity securities are recorded in Equity securities (ES) in the consolidated balance sheets. These are the most numerous and frequent derivative transactions. In addition, the Company from time to time purchases to be announced mortgage-backed securities (TBAs) as part of its investing activities.

The Company carries all derivative instruments at fair value with changes in fair value recorded in Net realized gains (losses) in the consolidated statements of operations. None of the derivative instruments are designated as hedges for accounting purposes.

The following table presents the balance sheet locations, fair values in an asset or (liability) position, and notional values/payment provisions of the Company's derivative instruments at December 31, 2017 and 2016.

(in thousands of U.S. dollars)	2017				2016			
	Consolidated Balance Sheet Location <sup>(1)</sup>	Fair Value		Notional Value/ Payment Provision	Consolidated Balance Sheet Location	Fair Value		Notional Value/ Payment Provision
	Derivative Asset	Derivative (Liability)				Derivative Asset	Derivative (Liability)	
<b>Investment and embedded derivative instruments</b>								
Foreign currency forward contracts	OA/(AP)	\$ 2,583	(2,496)	283,854	OA/(AP)	\$ 4,284	\$ (5,975)	\$ 495,414
Options / Futures contracts on notes and bonds	OA/(AP)	700	(317)	127,089	OA/(AP)	1,054	(935)	1,537,155
Convertible securities	FM AFS/ES	31	-	77	FM AFS/ES	39	0	39
		<u>3,314</u>	<u>(2,813)</u>	<u>411,020</u>		<u>5,377</u>	<u>(6,910)</u>	<u>\$ 2,032,608</u>
GLB <sup>(2)</sup>	(AP)/ (FPB)	\$ -	\$ (31,468)	\$ 452,914	(AP)/(FPB)	\$ -	\$ (103,793)	\$ 511,511

<sup>(1)</sup> Other assets (OA), Accounts payable (AP),Fixed maturities available for sale (FM AFS) and Equity securities (ES)

<sup>(2)</sup> Includes both future policy benefits reserves and fair value derivative adjustment. Refer to Note 5 c) for additional information. Note that the payment provision related to GLB is the net amount at risk. The concept of a notional value does not apply to the GLB reinsurance contracts.

At December 31, 2017 and 2016, derivative asset of \$0.5 million and derivative liability of \$1.6 million, respectively, included in the table above were subject to a master netting agreement. The remaining derivatives included in the table above were not subject to a master netting agreement.

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**(b) Secured borrowings**

The Company participates in a securities lending program operated by a third-party banking institution whereby certain assets are loaned to qualified borrowers and from which we earn an incremental return. At December 31, 2017 and 2016, the Company's securities lending payable, reflecting our obligation to return the collateral plus interest, was \$262.8 million and \$209.4 million, respectively, and the Company's securities lending collateral was \$262.8 million and \$209.3 million, respectively. The securities lending collateral can only be drawn down by the Company in the event that the institution borrowing the securities is in default under the lending agreement. An indemnification agreement with the lending agent protects us in the event a borrower becomes insolvent or fails to return any of the securities on loan. The collateral is recorded in Securities lending collateral and the liability is recorded in Securities lending payable in the consolidated balance sheets.

The following table presents the carrying value of collateral held under securities lending agreements by investment category and maturity date of the underlying agreements:

(in thousands of U.S. dollars)	Remaining contractual maturity	
	Overnight and Continuous	
	2017	2016
<i>Collateral held under securities lending agreements:</i>		
Cash	\$ 256,425	\$ 209,299
U.S. Treasury and agency	\$ 6,390	\$ -
	\$ 262,815	\$ 209,299
<i>Gross amount of recognized liabilities for securities lending payable</i>	<i>\$ 262,848</i>	<i>\$ 209,368</i>
<i>Difference <sup>(1)</sup></i>	<i>\$ (33)</i>	<i>\$ (69)</i>

<sup>(1)</sup> The carrying value of the securities lending collateral held is lower than the securities lending payable due to accrued interest recorded in the securities lending payable.

The Company has executed repurchase agreements with certain counterparties under which the Company agreed to sell securities and repurchase them at a future date for a predetermined price. At December 31, 2017 and 2016, there was \$551.8 million and \$551.9 million, respectively of reverse repurchase agreements outstanding with a weighted average interest rate of 1.62 percent and 0.76 percent, respectively. These agreements were fully collateralized.

In contrast to securities lending programs, the use of cash received is not restricted for the repurchase obligations. The fair value of the underlying securities sold remains in Fixed maturities available for sale and the repurchase agreement obligation is recorded in Repurchase agreements in the consolidated balance sheets.

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The following table presents the carrying value of collateral pledged under repurchase agreements by investment category and maturity date of the underlying agreements as at December 31, 2017 and 2016:

December 31, 2017 (in thousands of U.S. dollars)				Remaining contractual maturity	
	Up to 30 Days	30 - 90 Days	Greater than 90 Days	Total	
<i>Collateral pledged under repurchase agreements:</i>					
U.S. Treasury and agency	\$ -	\$ -	\$ 230,134	\$ 230,134	
Mortgage-backed securities	-	-	342,140	342,140	
	\$ -	\$ -	\$ 572,274	\$ 572,274	
Gross amount of recognized liabilities for repurchase agreements					\$ 551,840
Difference <sup>(1)</sup>					\$ 20,434

<sup>(1)</sup> Per the repurchase agreements, the amount of collateral posted is required to exceed the amount of gross liability.

December 31, 2016 (in thousands of U.S. dollars)				Remaining contractual maturity	
	Up to 30 Days	30 - 90 Days	Greater than 90 Days	Total	
<i>Collateral pledged under repurchase agreements:</i>					
U.S. Treasury and agency	\$ 229,917	\$ -	\$ -	\$ 229,917	
Mortgage-backed securities	339,578	-	-	339,578	
	\$ 569,495	\$ -	\$ -	\$ 569,495	
Gross amount of recognized liabilities for repurchase agreements					\$ 551,937
Difference <sup>(1)</sup>					\$ 17,558

<sup>(1)</sup> Per the repurchase agreements, the amount of collateral posted is required to exceed the amount of gross liability.

Potential risks exist in our secured borrowing transactions due to market conditions and counterparty exposure. With collateral that we pledge, there is a risk that the collateral may not be returned at the expiration of the agreement. If the counterparty fails to return the collateral, the Company will have free use of the borrowed funds until our collateral is returned. In addition, we may encounter the risk that the Company may not be able to renew outstanding borrowings with a new term or with an existing counterparty due to market conditions including a decrease in demand as well as more restrictive terms from banks due to increased regulatory and capital constraints. Should this condition occur, the Company may seek alternative borrowing sources or reduce borrowings. Additionally, increased margins and collateral requirements due to market conditions would increase our restricted assets as we are required to provide additional collateral to support the transaction.

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The following table presents net realized gains (losses) related to derivative instrument activity in the consolidated statements of operations:

(in thousands of U.S. dollars)	<b>2017</b>	<b>2016</b>
<b>Investment and embedded derivative instruments</b>		
Foreign exchange forward contracts	\$(6,043)	\$(5,825)
Future contracts on money market instruments	(996)	(4,428)
Convertible securities	(46)	2,959
Total investment and embedded derivative instruments	<b>\$(7,085)</b>	<b>\$(7,294)</b>
GLB	105,398	19,341
Total	<b>\$98,313</b>	<b>\$12,047</b>

#### *Derivative instrument objectives*

(i) **Foreign currency exposure management**

A foreign currency forward contract (forward) is an agreement between participants to exchange specific foreign currencies at a future date. The Company uses forwards to minimize the effect of fluctuating foreign currencies.

(ii) **Duration management and market exposure**

#### **Futures**

Futures contracts give the holder the right and obligation to participate in market movements, determined by the index or underlying security on which the futures contract is based. Settlement is made daily in cash by an amount equal to the change in value of the futures contract times a multiplier that scales the size of the contract. Exchange-traded bond and note futures contracts are used in fixed maturity portfolios to more efficiently manage duration, as substitutes for ownership of the money market instruments, bonds and notes without significantly increasing the risk in the portfolio. Investments in futures contracts may be made only to the extent that there are assets under management not otherwise committed.

(iii) **Convertible security investments**

A convertible security is a debt instrument or preferred stock that can be converted into a predetermined amount of the issuer's equity. The convertible option is an embedded derivative within the host instruments which are classified in the investment portfolio as either available for sale or as an equity security. The Company purchases convertible bonds for their total return and not specifically for the conversion feature.

(iv) **To be announced mortgage-backed securities (TBA)**

By acquiring a TBA, the Company makes a commitment to purchase a future issuance of mortgage-backed securities. For the period between purchase of the TBA and issuance of the underlying security, the Company accounts for the position as a derivative in the consolidated financial statements. The Company purchases TBAs both for their total return and for the flexibility they provide related to the mortgage-backed security strategy.

(v) **GLB**

Under the GLB program, as the assuming entity, the Company is obligated to provide coverage until the expiration or maturity of the underlying deferred annuity contracts or the expiry of the

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reinsurance treaty. Premiums received under the reinsurance treaties are classified as premium. Expected losses allocated to premiums received are classified as Future policy benefits. Other changes in fair value, principally arising from changes in expected losses allocated to expected future premiums, are classified as Net realized gains (losses). Fair value represents management's estimate of exit price and thus, includes a risk margin. The Company may recognize a realized loss for other changes in fair value due to adverse changes in the capital markets (e.g., declining interest rates and/or declining equity markets) and changes in actual or estimated future policyholder behavior (e.g., increased annuitization or decreased lapse rates). The Company believes this presentation provides the most meaningful disclosure of changes in the underlying risk within the GLB reinsurance programs for a given reporting period.

**(c) Concentrations of credit risk**

The Company's investment portfolio is managed following prudent standards of diversification. Specific provisions limit the allowable holdings of a single issue and issuer. The Company believes that there are no significant concentrations of credit risk associated with the investment portfolio. The Company's three largest exposures by issuer at December 31, 2017, were General Electric Company, Wells Fargo & Co. and Morgan Stanley. Our largest exposure by industry at December 31, 2017 was financial services.

**(d) Other Investments**

At December 31, 2017, included in Other investments in the Consolidated balance sheet are investments in limited partnerships and partially-owned investment companies with a carrying value of \$2.0 billion. In connection with these investments, we have commitments that may require funding of up to \$1.1 billion over the next several years.

**(e) Fixed maturities**

At December 31, 2017, we have commitments to purchase fixed income securities of \$56 million over the next several years.

**(f) Credit facilities and letters of credit**

On October 25, 2017, we replaced our \$1.5 billion letter of credit/revolver facility that was set to expire in November 2017 with an amended and restated credit facility that provides for up to \$1.0 billion of availability, all of which may be used for the issuance of letters of credit and for revolving loans. We have the ability to increase the capacity under our existing credit facility to \$2.0 billion under certain conditions, but any such increase would not raise the sub-limit for revolving loans above \$1.0 billion. The letter of credit facility required that we maintain certain financial covenants, all of which we met at December 31, 2017. At December 31, 2017, outstanding LOCs issued under this facility were \$250 million.

**(g) Guarantee**

During October 2007, the Company placed \$200 million in a trust account for the benefit of an affiliated company, ACE Property and Casualty Insurance Company, to secure the affiliate's reinsurance amounts due from other reinsurance companies.

In 2011, the Company entered into a funds withheld security arrangement with Chubb Insurance Limited (Chubb Australia), under which the Company agreed to provide collateral to support reinsurance balances recoverable that Chubb Australia carries in connection with business reinsured from CTR and other Chubb affiliates. The agreement requires collateral to be provided in connection with reinsurance balances recoverable from events that occurred at least two years prior. At December 31, 2017 the funds withheld balance totaled AUD\$302.1 million (\$232.4 million) of which a maximum of AUD\$80.8 million (\$62.2 million) could be used to support affiliate balances. At

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December 31, 2016 the funds withheld balance totaled AUD\$235.4 million (\$169.6 million) of which a maximum of AUD\$59.2 million (\$42.7 million) could be used to support affiliate balances.

#### **(h) Claims and Other Litigation**

The Company may be subject to litigation involving disputed interpretations of treaty coverages. These lawsuits, involving claims on treaties issued by our subsidiaries which are typical to the reinsurance industry in general and in the normal course of business, are considered in our loss and loss expense reserves. In addition to claims litigation, we are subject to lawsuits and regulatory actions in the normal course of business that do not arise from or directly relate to claims on reinsurance treaties. This category of business litigation typically involves, among other things, regulatory activity or disputes arising from our business ventures. In the opinion of management, our ultimate liability for these matters could be, but we believe is not likely to be, material to our consolidated financial condition and results of operations.

## **9. Shareholder's equity**

The Company's authorized share capital is \$100,000,000 consisting of 10,000,000 Common Shares of \$10 par value. The Company's issued share capital is \$2,800,000 consisting of 280,000 Common Shares of \$10 par value.

During the years ended December 31, 2017 and 2016 dividends amounting to \$380 million and \$600 million respectively, were declared.

## **10. Fair value measurements**

#### **(a) Fair value hierarchy**

Fair value of financial assets and financial liabilities is estimated based on the framework established in the fair value accounting guidance. The guidance defines fair value as the price to sell an asset or transfer a liability (an exit price) in an orderly transaction between market participants and establishes a three-level valuation hierarchy based on the reliability of the inputs. The fair value hierarchy gives the highest priority to quoted prices in active markets and the lowest priority to unobservable data.

The three levels of the hierarchy are as follows:

Level 1 – Unadjusted quoted prices for identical assets or liabilities in active markets;

Level 2 – Includes, among other items, inputs other than quoted prices that are observable for the asset or liability such as interest rates and yield curves, quoted prices for similar assets and liabilities in active markets, and quoted prices for identical or similar assets and liabilities in markets that are not active; and

Level 3 – Inputs that are unobservable and reflect management's judgments about assumptions that market participants would use in pricing an asset or liability.

The Company categorizes financial instruments within the valuation hierarchy at the balance sheet date based upon the lowest level of inputs that are significant to the fair value measurement. Accordingly, transfers between levels within the valuation hierarchy occur when there are significant changes to the inputs, such as increases or decreases in market activity, changes to the availability of current prices, changes to the transparency to underlying inputs, and whether there are significant variances in quoted prices. Transfers in and/or out of any level are assumed to occur at the end of the period.

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The Company uses pricing services to obtain fair value measurements for the majority of the Company's investment securities. Based on management's understanding of the methodologies used, these pricing services only produce an estimate of fair value if there is observable market information that would allow them to make a fair value estimate. Based on the Company's understanding of the market inputs used by the pricing services, all applicable investments have been valued in accordance with GAAP. The Company does not adjust prices obtained from pricing services. The following is a description of the valuation techniques and inputs used to determine fair values for financial instruments carried at fair value, as well as the general classification of such financial instruments pursuant to the valuation hierarchy.

#### **Fixed maturities**

The Company uses pricing services to estimate fair value measurements for the majority of the Company's fixed maturities. The pricing services use market quotations for fixed maturities that have quoted prices in active markets; such securities are classified within Level 1. For fixed maturities other than U.S. Treasury securities that generally do not trade on a daily basis, the pricing services prepare estimates of fair value measurements using their pricing applications, which include available relevant market information, benchmark curves, benchmarking of like securities, sector groupings, and matrix pricing. Additional valuation factors that can be taken into account are nominal spreads, dollar basis, and liquidity adjustments. The pricing services evaluate each asset class based on relevant market and credit information, perceived market movements, and sector news. The market inputs used in the pricing evaluation, listed in the approximate order of priority include: benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers, reference data, and industry and economic events. The extent of the use of each input is dependent on the asset class and the market conditions. Given the asset class, the priority of the use of inputs may change or some market inputs may not be relevant. Additionally, fixed maturities valuation is more subjective when markets are less liquid due to the lack of market based inputs (i.e., stale pricing), which may increase the potential that an investment's estimated fair value is not reflective of the price at which an actual transaction would occur. The overwhelming majority of fixed maturities are classified within Level 2 because the most significant inputs used in the pricing techniques are observable. For a small number of fixed maturities, the Company obtains a single broker quote (typically a market maker). Due to the disclaimers on the quotes that indicate that the price is indicative only, the Company includes these fair value estimates in Level 3.

#### **Equity securities**

Equity securities with active markets are classified within Level 1 as fair values are based on quoted market prices. For equity securities in markets which are less active, fair values are based on market valuations and are classified within Level 2. Equity securities for which pricing is unobservable are classified within Level 3.

#### **Short-term investments**

Short-term investments, which comprise securities due to mature within one year of the date of purchase that are traded in active markets, are classified within Level 1 as fair values are based on quoted market prices. Securities such as commercial paper and discount notes are classified within Level 2 because these securities are typically not actively traded due to their approaching maturity and, as such, their cost approximates fair value. Short-term investments for which pricing is unobservable are classified within Level 3.

#### **Other investments**

Fair values for the majority of Other investments including investments in partially-owned investment companies, investment funds, and limited partnerships are based on their respective

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net asset values or equivalent (NAV) and are excluded from the fair value hierarchy table below. Other investments for which pricing is unobservable are classified within Level 3.

#### **Securities lending collateral**

The underlying assets included in Securities lending collateral in the consolidated balance sheets are fixed maturities which are classified in the valuation hierarchy on the same basis as other fixed maturities. Excluded from the valuation hierarchy is the corresponding liability related to the Company's obligation to return the collateral plus interest as it is reported at contract value and not fair value in the consolidated balance sheets.

#### **Investment derivative instruments**

Actively traded investment derivative instruments, including futures, options, and exchange-traded forward contracts, are classified within Level 1 as fair values are based on quoted market prices. Investment derivative instruments are recorded in either Other assets, Accounts payable, accrued expenses, and other liabilities in the consolidated balance sheets.

#### **Other derivative instrument**

The Company generally maintains positions in other derivative instruments including exchange-traded equity futures contracts and option contracts designed to limit exposure to a severe equity market decline. The Company's position in exchange-traded equity futures contracts is classified within Level 1. At December 31, 2017 we held no positions in option contracts on equity market indices. The fair value of options on equity market indices is based on significant observable inputs and is accordingly classified within Level 2. Further, the Company's positions in the foreign currency forward contract are valued based on significant observable inputs and are therefore classified within Level 2.

#### **Guaranteed living benefits**

The GLB arises from life reinsurance programs covering living benefit guarantees whereby we assume the risk of guaranteed minimum income benefits (GMIB) and guaranteed minimum accumulation benefits (GMAB) associated with variable annuity contracts. GLB's are recorded in Accounts payable, accrued expenses, and other liabilities and Future policy benefits in the Consolidated balance sheets. For GLB reinsurance, the Company estimates fair value using an internal valuation model which includes current market information and estimates of policyholder behavior. All of the treaties contain claim limits, which are factored into the valuation model. The fair value depends on a number of factors, including interest rates, equity markets, credit risk, current account value, market volatility, expected annuitization rates and other policyholder behavior, and changes in policyholder mortality.

The most significant policyholder behavior assumptions include lapse rates and the GMIB annuitization rates. Assumptions regarding lapse rates and GMIB annuitization rates differ by treaty, but the underlying methodologies to determine rates applied to each treaty are comparable.

A lapse rate is the percentage of in-force policies surrendered in a given calendar year. All else equal, as lapse rates increase, ultimate claim payments will decrease. In general, the base lapse function assumes low lapse rates (ranging from about 4 percent to 8 percent per annum) during the surrender charge period of the GMIB contract, followed by a "spike" lapse rate (ranging from about 15 percent to 23 percent per annum) in the year immediately following the surrender charge period, and then reverting to an ultimate lapse rate (generally around 8 percent per annum), typically over a 2-year period. This base rate is adjusted downward for policies with more valuable guarantees (policies with guaranteed values far in excess of their account values) by multiplying the base lapse rate by a factor ranging from 15 percent to 75 percent. Partial

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withdrawals and the impact of older policyholders with tax-qualified contracts (due to required minimum distributions) are also reflected in our modeling.

The GMIB annuitization rate is the percentage of policies for which the policyholder will elect to annuitize using the guaranteed benefit provided under the GMIB. All else equal, as GMIB annuitization rates increase, ultimate claim payments will increase, subject to treaty claim limits. All GMIB reinsurance treaties include claim limits to protect the Company in the event that actual annuitization behavior is significantly higher than expected. In general, the Company assumes that GMIB annuitization rates will be higher for policies with more valuable guarantees (policies with guaranteed values far in excess of their account values).

The effect of changes in key market factors on assumed lapse and annuitization rates reflect emerging trends using data available from cedants. The model and related assumptions are regularly re-evaluated by management and enhanced, as appropriate, based upon additional experience obtained related to policyholder behavior and availability of updated information such as market conditions, market participant assumptions, and demographics of in-force annuities. Because of the significant use of unobservable inputs including policyholder behavior, GLB reinsurance is classified within Level 3.

In the fourth quarter of 2017, we completed a review of policyholder behavior related to annuitizations, partial withdrawals, lapses, and mortality for our variable annuity reinsurance business.

- As annuitization experience continued to emerge, we refined our annuitization assumptions including age-based behavior, which generally lowered the annuitization rate. The change in annuitization assumptions decreased the fair value of GLB liabilities and generated a realized gain of approximately \$62 million.
- Reinsured policies allow for policyholders to make periodic withdrawals from their account values without lapsing the policy. The partial withdrawal results in a reduction to the associated guaranteed value that is either equal or proportional to the amount of the reduction in account value. Based on continued emerging experience, we refined our assumptions around the types of partial withdrawals according to their impact on guaranteed value. This resulted in an increase to the fair value of GLB liabilities generating a realized loss of approximately \$32 million.
- As lapse experience continued to emerge, we further refined our assumptions which resulted in a net decrease to the fair value of GLB liabilities generating a realized gain of approximately \$2 million.
- We studied mortality experience for our variable annuity business for the first time this year and subsequently refined our mortality assumptions. The updated mortality rates increased the fair value of GLB liabilities generating a realized loss of approximately \$5 million.

In addition to the updates described above, we updated aspects of our valuation model relating to interest rates during the year ended December 31, 2017. This resulted in a decrease to the fair value of GLB liabilities generating a realized gain of approximately \$42 million.

During the year ended December 31, 2017, we also made minor technical refinements to the internal valuation model which resulted in no material impact on the financial statements.

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The following tables present, by valuation hierarchy, the financial instruments measured at fair value on a recurring basis, at December 31, 2017 and 2016.

<b>December 31, 2017</b>	<b>Level 1</b>	<b>Level 2</b> (in thousands of U.S. dollars)	<b>Level 3</b>	<b>Total</b>
<b>Assets:</b>				
<u>Fixed maturities available for sale</u>				
U.S. Treasury and agency	\$ 536,501	\$ 201,929	\$ -	\$ 738,430
Foreign	- -	3,269,143	3,325	3,272,468
Corporate securities	- -	4,695,658	42,680	4,738,338
Mortgage-backed securities	- -	2,712,979	50,114	2,763,093
States, municipalities, and political subdivisions	- -	221,325	- -	221,325
	536,501	11,101,034	96,119	11,733,654
Equity securities	142	- -	48	190
Short-term investments	202,114	116,360	- -	318,474
Securities lending collateral	- -	262,815	- -	262,815
Investment derivative instruments	3,283	- -	- -	3,283
Total assets measured at fair value (1)	\$ 742,040	\$ 11,480,209	\$ 96,167	\$ 12,318,416
<b>Liabilities:</b>				
Investment derivative instruments	2,813	- -	- -	2,813
GLB(2)	- -	- -	(71,864)	(71,864)
Total liabilities measured at fair value	\$ 2,813	\$ - -	\$ (71,864)	\$ (69,051)

- (1) Excluded from the table above are partially-owned investment companies and investment funds of \$2.0 billion at December 31, 2017 measured using NAV.
- (2) The GLB reinsurance product meets the definition of a derivative instrument for accounting purposes and is accordingly carried at fair value. Excluded from the table above is the portion of the GLB derivative liability classified as Future policy benefits in the consolidated balance sheets. Refer to Note 5 for additional information.

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December 31, 2016	Level 1	Level 2 (in thousands of U.S. dollars)	Level 3	Total
<b>Assets:</b>				
<u>Fixed maturities available for sale</u>				
U.S. Treasury and agency	\$ 568,575	\$ 239,368	\$ -	\$ 807,943
Foreign	-	2,791,839	3,643	2,795,482
Corporate securities	-	4,597,975	44,029	4,642,004
Mortgage-backed securities	-	2,570,846	123	2,570,969
States, municipalities, and political subdivisions	-	222,169	-	222,169
	<u>568,575</u>	<u>10,422,197</u>	<u>47,795</u>	<u>11,038,567</u>
Equity securities	834	-	1,738	2,572
Short-term investments	192,456	134,419	-	326,875
Securities lending collateral	-	209,299	-	209,299
Investment derivative instruments	5,338	-	-	5,338
Total assets measured at fair value (1)	<u>\$ 767,203</u>	<u>\$ 10,765,915</u>	<u>\$ 49,533</u>	<u>\$ 11,582,651</u>
<b>Liabilities:</b>				
Investment derivative instruments	6,910	-	-	6,910
GLB(2)	-	-	24,036	24,036
Total liabilities measured at fair value	<u>\$ 6,910</u>	<u>\$ -</u>	<u>\$ 24,036</u>	<u>\$ 30,946</u>

<sup>(1)</sup> Excluded from the table above are partially-owned investment companies and investment funds of \$1.9 billion at December 31, 2016 measured using NAV.

<sup>(2)</sup> The GLB reinsurance product meets the definition of a derivative instrument for accounting purposes and is accordingly carried at fair value. Excluded from the table above is the portion of the GLB derivative liability classified as Future policy benefits in the consolidated balance sheets. Refer to Note 5.

There were no transfers between Level 1 and Level 2 for the years ended December 31, 2017 and 2016.

**b) Fair value of alternative investments**

Alternative investments include investment funds, limited partnerships, and partially-owned investment companies measured at fair value using NAV as a practical expedient.

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The following table presents, by investment category, the expected liquidation period, fair values of and maximum future funding commitments related to these investments.

		<b>December 31, 2017</b>		<b>December 31, 2016</b>	
	Expected Liquidation Period	Fair Value (in thousands of U.S. dollars)	Maximum Future Funding Commitments	Fair Value	Maximum Future Funding Commitments
Financial	5 to 9 Years	\$ 263,639	\$ 257,942	\$ 250,431	\$ 327,820
Real Assets	3 to 7 Years	85,905	23,622	32,151	69,091
Distressed	3 to 7 Years	240,369	126,994	247,407	156,984
Private Credit	3 to 7 Years	143,127	264,177	178,485	189,449
Traditional	3 to 15 Years	1,022,459	430,642	933,268	609,169
Vintage	1 to 2 Years	439	-	1,294	-
Investment funds	Not Applicable	<u>269,773</u>	<u>-</u>	<u>251,445</u>	<u>-</u>
		<u>\$ 2,025,711</u>	<u>\$ 1,103,377</u>	<u>\$ 1,894,481</u>	<u>\$ 1,354,513</u>

Included in all categories in the above table except for investment funds are investments for which the Company will never have the contractual option to redeem but receives distributions based on the liquidation of the underlying assets. Included in the "Expected Liquidation Period" column above is the range in years over which the Company expects the majority of underlying assets in the respective categories to be liquidated. Further, for all categories except for Investment funds, the Company does not have the ability to sell or transfer the investments without the consent from the general partner of individual funds.

<b>Investment Category</b>	<b>Consists of investments in private equity funds:</b>
<i><b>Financial</b></i>	targeting financial services companies such as financial institutions and insurance services worldwide
<i><b>Real Assets</b></i>	targeting investments related to hard physical assets such as real estate, infrastructure and natural resources
<i><b>Distressed</b></i>	targeting distressed debit/credit and equity opportunities in the U.S.
<i><b>Private Credit</b></i>	targeting privately originated corporate debt investments including senior secured loans and subordinated bonds
<i><b>Traditional</b></i>	employing traditional private equity investment strategies such as buyout growth equity globally
<i><b>Vintage</b></i>	made before 2002 and where the funds' commitment periods had already expired
<b><i>Investment funds</i></b>	
The Company's investment funds employ various investment strategies such as long/short equity and arbitrage/distressed. Included in this category are investments for which the Company has the option to redeem at agreed upon value as described in each investment fund's subscription agreement. Depending on the terms of the various subscription agreements, investment fund investments may be redeemed monthly,	

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quarterly, semi-annually, or annually. If the Company wishes to redeem an investment fund investment, it must first determine if the investment fund is still in a lock-up period (a time when the Company cannot redeem its investment so that the investment fund manager has time to build the portfolio). If the investment fund is no longer in its lock-up period, the Company must then notify the investment fund manager of its intention to redeem by the notification date prescribed by the subscription agreement. Subsequent to notification, the investment fund can redeem the company's investment within several months of the notification. Notice periods for redemption of the investment funds range between 5 and 120 days. The Company can redeem its investment funds without consent from the investment fund managers.

#### **c) Level 3 financial instruments**

The fair value of assets and liabilities measured at fair value using significant unobservable inputs (Level 3) consist of various inputs and assumptions that management makes when determining fair value. Management analyzes changes in fair value measurements classified within Level 3 by comparing pricing and returns of investments to benchmarks, including month-over-month movements, investment credit spreads, interest rate movements, and credit quality of securities.

The following table presents the significant unobservable inputs used in the Level 3 valuations. Excluded from the table below are inputs used to fair value Level 3 assets which are based on single broker quotes or net asset value and contain no quantitative unobservable inputs developed by management.

(in thousands of U.S. dollars)	Fair Value at December 31, 2017	Valuation Technique	Significant Unobservable Inputs	Ranges
GLB <sup>(1)</sup>	\$ 71,864	Actuarial model	Lapse rate	4% - 23%
			Annuitization rate	0% - 25%

<sup>(1)</sup> Discussion of the most significant inputs used in the fair value measurement of GLB and the sensitivity of those assumptions is discussed previously in this footnote.

# Chubb Tempest Reinsurance Ltd. and its subsidiaries

## Notes to Consolidated Financial Statements

### For the years ended December 31, 2017 and 2016

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The following tables present a reconciliation of the beginning and ending balances of financial instruments measured at fair value using significant unobservable inputs (Level 3):

	<b>Year Ended December 31, 2017 (in thousands of U.S. dollars)</b>					<b>Liability</b>	
	<b>Assets</b>						
	<b>Available-for-Sale Debt Securities</b>						
	<b>Foreign</b>	<b>Corporate securities</b>	<b>MBS</b>	<b>Equity securities</b>	<b>GLB<sup>(1)</sup></b>		
Balance-Beginning of year	\$ 3,643	\$ 44,029	\$ 123	\$ 1,738	\$ 24,036	-	
Transfers into Level 3	-	23,363	50,000	-	9,498		
Change in Net Unrealized Gains (Losses) included in OCI	(72)	(2,163)	24	(60)	-	-	
Net Realized Gains/Losses	-	(1,238)	-	(768)	(105,398)		
Purchases	110	5,342	12	-	-	-	
Sales	(39)	(2,751)	-	(862)	-		
Settlements	(317)	(23,902)	(45)	-	-	-	
Balance-End of year	<u>\$ 3,325</u>	<u>\$ 42,680</u>	<u>\$ 50,114</u>	<u>\$ 48</u>	<u>\$ (71,864)</u>		
Net Realized Gains/Losses Attributable to Changes in Fair Value at the Balance Sheet Date	<u>\$ -</u>	<u>\$ (258)</u>	<u>\$ -</u>	<u>\$ (130)</u>	<u>\$ (105,398)</u>		

(1) The Company's GLB reinsurance product meets the definition of a derivative instrument for accounting purposes and is accordingly carried at fair value. Excluded from the table above is the portion of the GLB derivative liability classified as Future policy benefits in the consolidated balance sheets.

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	Year Ended December 31, 2016 (in thousands of U.S. dollars)					Liability	
	Assets						
	Available-for-Sale Debt Securities						
	Foreign	Corporate securities	MBS	Equity securities	GLB <sup>(1)</sup>		
Balance-Beginning of year	\$ 4,267	\$ 48,174	\$ 169	\$ 2,111	\$ 43,377		
Transfers into Level 3	323	6,942	-	-	-		
Change in Net Unrealized Gains (Losses) included in OCI	842	4,271	(7)	(569)	-		
Net Realized Gains/Losses	(546)	(3,674)	-	(238)	(19,341)		
Purchases	99	1,943	15	434	-		
Sales	(963)	(7,256)	-	-	-		
Settlements	(379)	(6,371)	(54)	-	-		
Balance-End of year	\$ 3,643	\$ 44,029	\$ 123	\$ 1,738	\$ 24,036		
Net Realized Gains/Losses Attributable to Changes in Fair Value at the Balance Sheet Date	\$ (136)	\$ (2,945)	\$ -	\$ -	\$ (19,341)		

- (1) Our GLB reinsurance product meets the definition of a derivative instrument for accounting purposes and is accordingly carried at fair value. Excluded from the table above is the portion of the GLB derivative liability classified as Future policy benefits in the consolidated balance sheets.

**d) Financial instruments disclosed, but not carried, at fair value**

The Company uses various financial instruments in the normal course of its business. The Company's reinsurance contracts are excluded from fair value of financial instruments accounting guidance and, therefore, are not included in the amounts discussed below.

The carrying values of cash, other assets, other liabilities, and other financial instruments not included below approximated their fair values.

**Investments in partially-owned insurance companies**

The fair values of the Company's investments in partially-owned insurance companies are based on the share of the net assets based on the financial statements provided by those companies and are excluded from the valuation hierarchy tables below.

**Repurchase agreements**

Where practical, fair values of repurchase agreements are estimated using discounted cash flow calculations based principally on observable inputs including incremental borrowing rates, which reflect our credit rating, for similar types of borrowings with maturities consistent with those remaining for the debt being valued.

# **Chubb Tempest Reinsurance Ltd. and its subsidiaries**

## **Notes to Consolidated Financial Statements**

### **For the years ended December 31, 2017 and 2016**

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The following tables present fair value, by valuation hierarchy, and carrying value of the financial instruments not measured at fair value:

<b>December 31, 2017</b> (in thousands of U.S. dollars)	<b>Fair Value</b>				<b>Carrying Value</b>	
	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>		
<b>Assets:</b>						
Fixed Maturities held to maturity:						
Corporate securities	-	2,393	-	2,393	2,258	
Mortgage-backed securities	-	6,167	-	6,167	5,881	
Total assets	-	8,560	-	8,560	8,139	
<b>Liabilities:</b>						
Repurchase Agreements	-	551,840	-	551,840	551,840	

<b>December 31, 2016</b> (in thousands of U.S. dollars)	<b>Fair Value</b>				<b>Carrying Value</b>	
	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>		
<b>Assets:</b>						
Fixed Maturities held to maturity:						
Corporate securities	-	2,658	-	2,658	2,465	
Mortgage-backed securities	-	7,503	-	7,503	7,111	
Total assets	-	10,161	-	10,161	9,576	
<b>Liabilities:</b>						
Repurchase Agreements	-	551,937	-	551,937	551,937	

## **11. Taxation**

Under current Bermuda law, the Company and its Bermuda subsidiaries are not required to pay any taxes on income or capital gains. If a Bermuda law were enacted that would impose taxes on income or capital gains, Chubb Limited and the Bermuda subsidiaries have received an undertaking from the Minister of Finance in Bermuda that would exempt such companies from Bermudian taxation until March 2035.

The Company does not consider itself to be engaged in trade or business in the United States and, accordingly, does not expect to be subject to United States taxation.

## **12. Statutory financial information**

The Company is registered under The Insurance Act 1978 (Bermuda), amendments thereto and related regulations (the “Act”) as a Class 4 insurer. Effective January 1, 2016, Bermuda implemented a new solvency and risk management regime which has been deemed equivalent to the EU’s Solvency II regime. Bermuda statutory reporting rules have been amended to introduce an economic balance sheet (“EBS”) framework. The Company calculates statutory capital using the Bermuda Statutory Capital Requirement (BSCR) model. The BSCR is a risk-based capital model to measure risk and to determine an enhanced capital requirement and target capital level (defined as 120% of the enhanced capital requirement (“ECR”)) for Class 4 insurers. Statutory capital and surplus of the Company was \$8.6 billion and \$8.0 billion at December 31, 2017 and 2016, respectively. For the years ended December 31, 2017 and 2016, the ECR was

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## **Notes to Consolidated Financial Statements**

### **For the years ended December 31, 2017 and 2016**

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\$2.3 billion and \$2.2 billion, respectively. The minimum solvency margin required at December 31, 2017 was \$2.0 billion and was met by the Company.

A Class 4 insurer is prohibited from declaring or paying a dividend if in breach of its ECR, solvency margin or minimum liquidity ratio or if the declaration or payment of such dividend would cause such a breach. Where an insurer fails to meet its solvency margin or minimum liquidity ratio on the last day of any financial year, it is prohibited from declaring or paying any dividends during the next financial year without the approval of the Bermuda Monetary Authority (the Authority). Further, a Class 4 insurer is prohibited from declaring or paying in any financial year dividends of more than 25% of its total statutory capital and surplus (as shown on its previous financial year's statutory balance sheet) unless it files (at least seven days before payment of such dividends) with the Authority an affidavit signed by at least two directors and the insurer's principal representative stating that the declaration of such dividends has not caused the insurer to fail to meet its solvency margin or minimum liquidity ratio. Class 4 insurers must obtain the Authority's prior approval for a reduction by 15% or more of the total statutory capital as set forth in its previous year's statutory financial statements.

#### **13. Subsequent events**

The Company has performed an evaluation of subsequent events through April 27, 2018, which is the date that the financial statements were issued.

Effective January 1, 2018, CTRL non-renewed the 15% quota share reinsurance treaty with the affiliated Chubb North American (NA) Pool ("the NA Pool") companies on a cut-off basis. Assumed gross written premium from the NA Pool quota share was \$1,026.8 million in 2017.

Effective March 15, 2018, the Company entered into a loan agreement with CTLR, its parent company (the Loan Agreement). Under the Loan Agreement, the Company agreed to lend CTLR \$300 million at an interest rate of 3.15 percent. Interest on the loan is payable annually and the principal is payable on March 15, 2023.

Effective April 9, 2018, AELL changed its name from ACE Europe Life Limited to ACE Europe Life Plc (AELP).

No other significant subsequent events were identified.