ARMOUR RE LTD.

FINANCIAL STATEMENTS

For the Year Ended December 31, 2018 and the Period Ended December 31, 2017

3rd Floor, 19 Par-la-Ville Road, Hamilton HM 11, Bermuda

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April 30, 2019

Report of Independent Auditors

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

We have audited the accompanying financial statements of Armour Re Ltd., which comprise the balance sheets as of December 31, 2018 and 2017, and the related statements of income (loss) and comprehensive income (loss), of changes in shareholder's equity and of cash flows for the year ended December 31, 2018 and for the period from November 20, 2017 (date of incorporation) to December 31, 2017.

Management's responsibility for the financial statements

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

Auditors' responsibility

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

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

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Opinion
In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Armour Re Ltd. as of December 31, 2018 and 2017, and the results of its operations and its cash flows for the year ended December 31, 2018 and for the period from November 20, 2017 (date of incorporation) to December 31, 2017 in accordance with accounting principles generally accepted in the United States of America.

Other Matter
Accounting principles generally accepted in the United States of America require that the required supplemental information under Accounting Standards Update 2015-09, Disclosure about Short-Duration Contracts labelled as Unaudited within Note 6 on pages 16 to 19 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Financial Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

PricewaterhouseCoopers Ltd.

Chartered Professional Accountants

ARMOUR RE LTD.

BALANCE SHEETS

As at December 31, 2018 and 2017

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

	December 31, 2018	December 31, 2017
ASSETS		
Cash and cash equivalents	$ 36,273,515	$ —
Premiums receivable	5,352,470	193,617,732
Funds withheld	192,999,506	—
Due from shareholder	—	122,147,132
Due from cedant	3,739,755	—
Deferred charge	11,804,082	26,645,370
Other assets	496,676	—
TOTAL ASSETS	$ 250,666,004	$ 342,410,234
LIABILITIES		
Reserve for losses and loss adjustment expenses	$ 105,657,865	$ 209,889,523
Unearned premiums	46,448	10,373,578
Due to cedant	4,767,751	—
Due to shareholder	1,115,551	—
Other liabilities	2,111,794	183,076
TOTAL LIABILITIES	113,699,409	220,446,177
COMMITMENTS AND CONTINGENCIES		
SHAREHOLDER'S EQUITY		
Share capital:		
Ordinary shares ($1.00 par; 10,000,000 shares authorized; 120,000 shares issued and outstanding).	120,000	120,000
Additional paid-in capital	132,669,167	122,080,105
Retained earnings (deficit)	4,177,428	(236,048)
TOTAL SHAREHOLDER'S EQUITY	136,966,595	121,964,057
TOTAL LIABILITIES AND SHAREHOLDER'S EQUITY	$ 250,666,004	$ 342,410,234

See accompanying notes to the financial statements

ARMOUR RE LTD.

STATEMENTS OF INCOME (LOSS) AND COMPREHENSIVE INCOME (LOSS)

For the Year Ended December 31, 2018 and
the Period from November 20, 2017 (date of incorporation) to December 31, 2017

(Expressed in U.S. dollars)

	2018	2017
INCOME		
Net premiums earned	$ 9,218,119	$ —
Net investment income	4,071,009	—
Net realized and change in net unrealized losses	(853,531)	—
Other income	2,999,493	—
TOTAL INCOME	15,435,090	—
EXPENSES		
Net losses and loss adjustment expenses	4,921,080	—
Other reinsurance expenses	5,119,933	—
General and administrative expenses	1,011,613	236,048
Net foreign exchange gains	(31,012)	—
TOTAL EXPENSES	11,021,614	236,048
NET INCOME (LOSS) AND COMPREHENSIVE INCOME (LOSS)	$ 4,413,476	$ (236,048)

See accompanying notes to the financial statements

ARMOUR RE LTD.

STATEMENTS OF CHANGES IN SHAREHOLDER'S EQUITY

For the Year Ended December 31, 2018 and the Period from November 20, 2017 (date of incorporation) to December 31, 2017

(Expressed in U.S. dollars)

	2018	2017
Share capital — ordinary shares		
Balance, beginning of year / period	$ 120,000	$ —
Issuance of shares	—	120,000
Balance, end of year / period	$ 120,000	$ 120,000
Additional paid-in capital		
Balance, beginning of year / period	$ 122,080,105	$ —
Contribution from shareholder	10,589,062	122,080,105
Balance, end of year / period	$ 132,669,167	$ 122,080,105
Retained earnings (deficit)		
Balance, beginning of year / period	$ (236,048)	$ —
Net income (loss)	4,413,476	(236,048)
Balance, end of year / period	$ 4,177,428	$ (236,048)
TOTAL SHAREHOLDER'S EQUITY	$ 136,966,595	$ 121,964,057

See accompanying notes to the financial statements

ARMOUR RE LTD.

STATEMENTS OF CASH FLOWS

For the Year Ended December 31, 2018 and the Period from November 20, 2017 (date of incorporation) to December 31, 2017

(Expressed in U.S. dollars)

	2018	2017
OPERATING ACTIVITIES:		
Net income (loss)	$ 4,413,476	$ (236,048)
Adjustments to reconcile net income (loss) to cash flows used in operating activities:		
Net realized and change in net unrealized losses	853,531	—
Accretion of discount	(1,171,900)	—
Amortization of deferred charge	7,896,338	—
Changes in:		
Premiums receivable	188,265,262	(193,617,732)
Funds withheld	(192,681,137)	—
Due from cedant	(3,739,755)	—
Deferred charge	6,944,950	(26,645,370)
Other assets	(496,676)	—
Reserve for losses and loss adjustment expenses	(104,231,658)	209,889,523
Unearned premiums	(10,327,130)	10,373,578
Due to cedant	4,767,751	—
Due to shareholder	1,115,551	—
Other liabilities	1,928,718	183,076
Net cash flows used in operating activities	(96,462,679)	(52,973)
FINANCING ACTIVITIES:		
Issuance of shares	$ 120,000	$ —
Contribution by shareholder	132,616,194	52,973
Net cash flows provided by financing activities	132,736,194	52,973
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	36,273,515	—
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR / PERIOD	—	—
CASH AND CASH EQUIVALENTS, END OF YEAR / PERIOD	$ 36,273,515	$ —
SUPPLEMENTAL INFORMATION:		
Income taxes paid	$ —	$ —
Interest paid	$ —	$ —

See accompanying notes to the financial statements

(Tabular information expressed in U.S. dollars)

1. DESCRIPTION OF BUSINESS

Armour Re Ltd. ("Armour Re" or the "Company") is a Bermuda exempted company registered as a Class 3B insurer under the Bermuda Insurance Act 1978. The Company was incorporated on November 20, 2017 and is wholly-owned by Armour Group Ltd. ("AGL").

The primary purpose of the Company is to acquire discontinued property and casualty business in the non-life sector of the insurance industry from insurers, reinsurers and/or other entities (including, without limitation, self-insured organizations) and the management of the payment of future claims and the assets supporting such liabilities. Unless the context indicates otherwise, the terms the "Company," "Armour Re," "we," "us" or "our" mean Armour Re Ltd.

Co-Investment Framework Agreement

On December 29, 2017, the Company, together with its affiliates, parallel vehicles, co-investment vehicles, alternative vehicles, subsidiaries and other related investment vehicles (collectively the "PCV Vehicle"), and ILS Property & Casualty Fund II, L.P. ("Fund II") entered into a Co-Investment Framework Agreement, which was amended and restated on December 5, 2018, whereby the PCV Vehicle agreed that a pro rata portion, based on Fund II's total capital commitments and the PCV Vehicle's aggregate equity capital, determined as of the time of the proposed investment (the "Co-Investment Ratio") will be offered to Fund II and Fund II shall be entitled to invest in such opportunity in any amount up to the applicable Co-Investment Ratio or to decline such investment.

Both parties also agreed that subsequent changes to the Co-Investment Ratio, due to the subsequent closing of the commitment period of Fund II or a change in the equity capital of the PCV run-off pool, to re-allocate their respective interest in the Co-Investment based on the Revised Co-Investment Ratio (the "Re-Allocation").

Initial Co-Investments were made based on the Co-Investment Ratio at the time of the Co-Investment with subsequent capital Re-Allocations occurring four times in 2018. On November 30, 2018, the commitment period of Fund II closed resulting in the Co-Investment Ratio being permanently set on that date.

For those Co-Investments that were Re-Allocated between the PCV Vehicle and Fund II, the percentage share of the Co-Investments transferred was made at cost plus interest at a rate equal to 8% per annum from the date such Co-Investment was made to the date of such transfer. During the year ended December 31, 2018, the Company received approximately $2.9 million of net interest income, included in other income, from Fund II related to the Re-Allocation of Co-Investments that occurred during the year.

The Co-investment Ratios as at December 31, 2018 and 2017 were as follows:

Co-investment Ratio as at:	PCV Vehicle	Fund II
December 31, 2017	44.15 %	55.85%
December 31, 2018	32.65 %	67.35%
Change in the year	(11.50)%	11.50%

Based on the change in the PCV Vehicle Co-Investment Ratio during 2018, the Company adjusted the December 31, 2017 take-on balances of Portfolio 1 which resulted in reductions to certain amounts, primarily premiums receivable, due from shareholder, deferred charge, reserve for losses and loss adjustment expenses, unearned premiums and additional paid-in capital in the year.

For the PCV Vehicle and Fund II, the Co-Investments are primarily undertaken through their Bermuda registered Class 3B insurers being Armour Re and ILS Property & Casualty Re II Limited ("PC RE II"), respectively.

2. SIGNIFICANT ACCOUNTING POLICIES

Basis of Preparation

The financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America ("U.S. GAAP"). The financial statements include our assets, liabilities and results of operations as at December 31, 2018 and 2017 and for the year ended December 31, 2018 and for the period from November 20, 2017 (date of incorporation) to December 31, 2017.

Use of Estimates

The preparation of financial statements in accordance with U.S. GAAP requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Our actual results could differ materially from our estimates. Accounting policies that we believe are most dependent on assumptions and estimates are considered to be our critical accounting policies and are related to the determination of:

- reserves for losses and loss adjustment expenses ("LAE"); and
- fair value measurements of funds withheld - directly managed investments.

Significant Accounting Policies

(a) Premiums

Premiums written are earned on a pro-rata basis over the period the coverage is provided. Premiums are recorded at the inception of the policy, are based upon contractual terms and, for certain business, are estimated based on underlying contracts or from information provided by insureds and/or brokers. Changes in premium estimates are expected and may result in adjustments in future periods. Any subsequent differences arising on such estimates are recorded as premiums written in the period in which they are determined.

Premiums receivable

Premiums receivable represent amounts currently due and amounts not yet due on reinsurance policies. Premiums for reinsurance policies generally become due over the period of coverage based on the policy terms. We monitor the credit risk associated with premiums receivable, taking into consideration the impact of our contractual right to offset loss obligations or unearned premiums against premiums receivable. Amounts deemed uncollectible are charged to the Statement of Income (Loss) and Comprehensive Income (Loss) in the period they are determined. Changes in the estimates of premiums written will result in an adjustment to premiums receivable in the period they are determined.

Unearned premiums

Unearned premiums represent the portion of premiums written that relate to the unexpired terms of policies in force.

(b) Losses and LAE

The reserve for losses and LAE includes an amount determined from reported claims ("OSLR") and an amount, based on historical loss experience and industry statistics, for losses incurred but not yet reported ("IBNYR") and losses incurred but not enough reported ("IBNER"). IBNYR plus IBNER are commonly referred to collectively as IBNR. The ultimate claims reserves (OSLR plus IBNR) is established by management based on actuarial analysis of data provided by brokers, ceding companies and insureds and represents the estimated ultimate net outstanding claims liabilities. These estimates are continually reviewed and are necessarily subject to the impact of future changes in factors such as claim severity and frequency, changes in economic conditions including the impact of inflation, legal and judicial developments, and medical cost trends. While we believe that the amount is adequate, the ultimate liability may be in excess of, or less than, the amounts provided. Adjustments will be reflected as part of net increase or reduction in losses and LAE liabilities in the periods in which they become known. Premium and commission adjustments may be triggered by incurred losses, and any amounts are recorded in the same period that the related incurred loss is recognized.

We establish provisions for LAE relating to run-off costs for the estimated duration of the run-off, which are included in losses and LAE. These provisions are assessed at each reporting date, and provisions relating to future periods are adjusted to reflect any changes in estimates of the periodic run-off costs or the duration of the run-off, including the impact of any acceleration of the run-off period that may be caused by commutations.

(c) Cash and Cash Equivalents

Cash equivalents include all highly liquid debt instruments purchased with an original maturity of three months or less.

(d) Funds Withheld

Under funds withheld arrangements, the reinsured company has retained funds that would otherwise have been remitted to us. The funds withheld balance is credited with investment income and losses payable are deducted. The investment returns of funds withheld are recognized in net investment income. Funds withheld upon which we receive the underlying portfolio economics are disclosed in the notes to the financial statements as funds withheld - directly managed.

(e) Foreign Exchange

Our functional currency is the U.S. dollar. Monetary assets and liabilities denominated in foreign currencies are translated at exchange rates in effect at the balance sheet date. Foreign currency revenues and expenses are translated at average exchange rates during the year. These exchange gains and losses are recognized in the Statement of Income (Loss) and Comprehensive Income (Loss). Non-monetary assets and liabilities denominated in foreign currencies are translated at exchange rates in effect at the time of the underlying transaction.

(f) Retroactive Reinsurance and Deferred Charges

Retroactive reinsurance policies provide indemnification of losses and LAE with respect to past loss events.

We use the balance sheet accounting approach for assumed loss portfolio transfers, whereby at the inception of the contract there are no premiums or losses recorded in the Statement of Income (Loss) and Comprehensive Income (Loss). At the inception of a contract, a deferred charge asset is recorded for the excess, if any, of the estimated ultimate losses payable over the premiums received. Deferred charges are amortized over the estimated claim payment period of the related contract with the periodic amortization reflected in Statement of Income (Loss) and Comprehensive Income (Loss) as a component of losses and LAE. The deferred charge amortization is adjusted at each reporting period to reflect new estimates of the amount and timing of remaining loss payments. Changes in the estimated amount and the timing of payments of unpaid losses may have an effect on the unamortized deferred charges and the amount of periodic amortization. Deferred charges are assessed at each reporting period for impairment. If the asset is determined to be impaired, it is written down in the period in which the determination is made.

Recently Issued Accounting Pronouncements Not Yet Adopted

Accounting Standards Update ("ASU") 2018-13, Changes to the Disclosure Requirements for Fair Value Measurements

In August 2018, the Financial Accounting Standards Board ("FASB") issued ASU 2018-13, which amended the fair value measurement guidance in ASC 820 - Fair Value Measurement, by removing and modifying certain existing disclosure requirements. The ASU is effective for annual reporting periods beginning after December 15, 2019, although early adoption is permitted, with the amendments being applied either prospectively or retrospectively, as specified in the ASU. We do not expect the modified disclosures to have a material impact on our financial statements.

3. SIGNIFICANT NEW BUSINESS

2019

Portfolio 4

On February 18, 2019, we entered into a loss portfolio transfer agreement (“LPTA”) to reinsure a portfolio of Italian medical malpractice liability lines of business. Concurrently, we entered into a quota share retrocession agreement ("QS Agreement") with PC RE II in relation to the LPTA whereby PC Re II funded $16.3 million, and we funded $7.9 million, representing the capital required to fund the reinsurance up to the aggregate limit under the terms of the LPTA along with funding of deal related expenses.

Portfolio 3

On January 31, 2019, we entered into a LPTA to reinsure a portfolio of US general liability, commercial package including and excluding US wind cover and miscellaneous professional and liquor liability. Concurrently, we entered into a QS Agreement with PC RE II in relation to the LPTA whereby PC Re II funded $82.9 million, and we funded $40.2 million, representing the total capital required to fund the reinsurance up to the aggregate limit under the terms of the LPTA along with funding of deal related expenses.

2018

Portfolio 2

On March 5, 2018, we entered into a QS Agreement with PC RE II in relation to the LPTA it entered to reinsure a portfolio of U.K. commercial motor, public and employers' liability lines of business along with property/premises related to U.K. commercial motor. Pursuant to the agreement, we have indemnified PC Re II for our quota share percentage of the ultimate net loss and other liabilities incurred by PC Re II under the LPTA. The Company has provided capital of $9.2 million to fund its quota share percentage of the aggregate limit under the terms of the LPTA and assumed $14.2 million of reserves for losses and LAE.

2017

Portfolio 1

On December 29, 2017, we entered into a QS Agreement with PC Re II in relation to the LPTA it entered to reinsure a portfolio of legacy business which primarily includes Commercial Automobile, Non-Standard Personal Automobile, General Liability, Commercial and Personal Property, Mono-line Liquor Liability, Real Estate E&O, Workers’ Compensation and other smaller lines of business. Taking into account the impact of the change in the Co-Investment Ratio, we contributed $89.6 million to PC Re II representing our proportionate share of the required collateral to fully fund the trade up to its aggregate limit; assumed $155.2 million of reserves for losses and LAE; and was credited with $143.2 million of premiums due under the LPTA to funds withheld.

4. FUNDS WITHHELD

The following table provides the total funds withheld balance as at December 31, 2018:

	December 31, 2018
Funds withheld	$ 28,095,185
Funds withheld - directly managed restricted cash and cash equivalents	39,303,346
Funds withheld - directly managed short-term investments	52,283,276
Funds withheld - directly managed fixed maturity investments	73,317,699
Total funds withheld	$ 192,999,506

The fair values of our funds withheld - directly managed investments classified as trading were as follows:

	December 31, 2018
U.S. government and agency	$ 92,203,440
Non-U.S. government	7,789,327
Corporate	25,608,208
Total funds withheld - directly managed investments	$ 125,600,975

The contractual maturities of our funds withheld - directly managed investments classified as trading are shown below. Actual maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

As at December 31, 2018	Amortized Cost	Fair Value	% of Total Fair Value
One year or less	$ 75,127,985	$ 75,072,652	59.8%
More than one year through two years	22,195,728	22,115,678	17.6%
More than two years through five years	24,348,697	24,371,194	19.4%
More than five years through ten years	4,005,494	4,041,451	3.2%
Total funds withheld - directly managed investments	$ 125,677,904	$ 125,600,975	100.0%

The following table sets forth the credit ratings of our funds withheld - directly managed investments as at December 31, 2018:

	Amortized Cost	Fair Value	% of Total Fair Value	AAA Rated	AA Rated	A Rated
U.S. government and agency	$ 92,238,202	$ 92,203,440	73.4%	$ 22,849,265	$ 69,354,175	$ —
Non-U.S. government	7,777,174	7,789,327	6.2%	6,520,692	1,268,635	—
Corporate	25,662,528	25,608,208	20.4%	2,034,535	19,056,371	4,517,302
Total	$ 125,677,904	$ 125,600,975	100.0%	$ 31,404,492	$ 89,679,181	$ 4,517,302
% of total fair value				25.0%	71.4%	3.6%

Net Investment Income on Funds Withheld - Directly Managed

Major categories of net investment income on funds withheld - directly managed for the year ended December 31, 2018 is summarized as follows:

		2018
Restricted cash and cash equivalents	$	400,907
Short-term investments		666,716
Fixed maturity investments		2,833,399
Gross investment income on funds withheld - directly managed		3,901,022
Investment expenses on funds withheld - directly managed		(160,101)
Net investment income on funds withheld - directly managed	$	3,740,921
Net investment income - other		330,088
Net investment income	$	4,071,009

Net Realized and Change in Net Unrealized Losses on Funds Withheld - Directly Managed

Components of net realized and change in net unrealized losses on funds withheld - directly managed for the year ended December 31, 2018 were as follows:

		2018
Net realized losses on funds withheld - directly managed:		
Fixed maturity investments, trading	$	(706,443)
Short-term investments, trading		(77)
Restricted cash and cash equivalents		19
Total net realized losses on funds withheld - directly managed		(706,501)
Change in net unrealized losses on funds withheld - directly managed:		
Fixed maturity investments, trading		(141,865)
Short-term investments, trading		(6,077)
Restricted cash and cash equivalents		912
Total change in net unrealized losses on funds withheld - directly managed		(147,030)
Net realized and change in net unrealized losses on funds withheld - directly managed	$	(853,531)

5. FAIR VALUE MEASUREMENTS

Fair Value Hierarchy

Fair value is defined as the price at which to sell an asset or transfer a liability (i.e. the "exit price") in an orderly transaction between market participants. We use a fair value hierarchy that gives the highest priority to quoted prices in active markets and the lowest priority to unobservable data.

The hierarchy is broken down into three levels as follows:

- Level 1 - Valuations based on unadjusted quoted prices in active markets for identical assets or liabilities that we have the ability to access.
- Level 2 - Valuations based on quoted prices in active markets for similar assets or liabilities, quoted prices for identical or similar assets or liabilities in inactive markets, or for which significant inputs are observable (e.g. interest rates, yield curves, prepayment speeds, default rates, loss severities, etc.) or can be corroborated by observable market data.

- Level 3 - Valuations based on unobservable inputs where there is little or no market activity. Unadjusted third party pricing sources or management's assumptions and internal valuation models may be used to determine the fair values.

We have categorized our funds withheld - directly managed investments that are recorded at fair value on a recurring basis among levels based on the observability of inputs as follows:

	December 31, 2018			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Fair Value
Funds Withheld - Directly Managed:				
U.S. government and agency	$ —	$ 92,203,440	$ —	$ 92,203,440
Non-U.S. government	—	7,789,327	—	7,789,327
Corporate	—	25,608,208	—	25,608,208
Total	$ —	$ 125,600,975	$ —	$ 125,600,975

Valuation Methodologies of Financial Instruments Measured at Fair Value

Funds Withheld - Directly Managed Investments

The fair values for all securities in the funds withheld - directly managed portfolios are independently provided by the investment manager, which utilizes internationally recognized independent pricing services. We record the price provided by the investment manager and do not adjust prices obtained from the pricing service.

The independent pricing services used by the investment manager obtain actual transaction prices for securities that have quoted prices in active markets. Where we utilize single unadjusted broker-dealer quotes, they are generally provided by market makers or broker-dealers who are recognized as market participants in the markets in which they are providing the quotes. For determining the fair value of securities that are not actively traded, in general, pricing services use "matrix pricing" in which the independent pricing service uses observable market inputs including, but not limited to, reported trades, benchmark yields, broker-dealer quotes, interest rates, prepayment speeds, default rates and such other inputs as are available from market sources to determine a reasonable fair value.

The following describes the techniques generally used to determine the fair value of our funds withheld - directly managed investments by asset class.

- U.S. government and agency securities consist of securities issued by the U.S. Treasury. Non-U.S. government securities consist of bonds issued by non-U.S. governments and agencies along with supranational organizations. The significant inputs used to determine the fair value of these securities include the spread above the risk-free yield curve, reported trades and broker-dealer quotes. These are considered to be observable market inputs and, therefore, the fair values of these securities are classified as Level 2.

- Corporate securities consist primarily of investment-grade debt of a wide variety of corporate issuers and industries. The fair values of these securities are determined using the spread above the risk-free yield curve, reported trades, broker-dealer quotes, benchmark yields, and industry and market indicators. These are considered observable market inputs and, therefore, the fair values of these securities are classified as Level 2. Where pricing is unavailable from pricing services, such as in periods of low trading activity or when transactions are not orderly, we obtain non-binding quotes from broker-dealers. Where significant inputs are unable to be corroborated with market observable information, we classify the securities as Level 3.

Changes in Leveling of Financial Instruments

Transfers into or out of levels are recorded at their fair values as at the end of the reporting period, consistent with the date of determination of fair value. During the year ended December 31, 2018, there were no transfers between levels.

Disclosure of Fair Values for Financial Instruments Carried at Cost

Disclosure of fair value of amounts relating to insurance contracts is not required. Our remaining assets and liabilities were generally carried at cost or amortized cost, which due to their short-term nature approximates fair value as at December 31, 2018 and 2017. As these assets and liabilities are not actively traded, their respective fair values are classified as Level 2.

6. RESERVE FOR LOSSES AND LOSS ADJUSTMENT EXPENSES

The liability for losses and LAE, also referred to as loss reserves, represents our gross estimates before for unpaid reported losses and losses that have been incurred but not reported ("IBNR"). LAE reserves include allocated loss adjustment expenses ("ALAE"), and unallocated loss adjustment expenses ("ULAE"). ALAE are linked to the settlement of an individual claim or loss, whereas ULAE are based on our estimates of future costs to administer the claims. IBNR represents reserves for losses and LAE that have been incurred but not yet reported to us. This includes amounts for unreported claims, development on known claims and reopened claims.

The following table summarizes the liability for losses and LAE as at December 31, 2018 and 2017:

	December 31,	
	2018	2017
Outstanding losses	$ 60,619,630	$ 97,230,656
IBNR	38,557,207	101,947,771
ULAE	6,481,028	10,711,096
Total	$ 105,657,865	$ 209,889,523

The table below provides a reconciliation of the beginning and ending liability for losses and LAE for the year ended December 31, 2018 and the period from November 20, 2017 (date of incorporation) to December 31, 2017:

	2018	2017
Balance as at January 1, (2017: November 20,)	$ 209,889,523	$ —
Less: deferred charge on retroactive reinsurance	26,645,370	—
Net balance as at January 1, (2017 : November 20,)	183,244,153	—
Net incurred losses and LAE:		
Prior periods	4,921,080	—
Total net incurred losses and LAE	4,921,080	—
Net paid losses:		
Prior periods	(60,149,214)	—
Total net paid losses	(60,149,214)	—
Effect of exchange rate movement	(647,496)	—
Assumed business [1]	(33,514,740)	183,244,153
Net balance as at December 31,	93,853,783	183,244,153
Plus: deferred charge on retroactive reinsurance	11,804,082	26,645,370
Balance as at December 31,	$ 105,657,865	$ 209,889,523

[1] As disclosed in Note 1 - "Description of Business", during 2018 the acquired reserves relating to Portfolio 1 were reduced in line with the change in the Co-Investment Ratio. This reduction was partially offset by the assumed reserves related to Portfolio 2, discussed in Note 3 - "Significant New Business."

Short Duration Contract Disclosures

The Company has presented the below development tables shown using exchange rates as at December 31, 2018. The reserve for losses and loss expenses related to the completion of the Portfolio 1 and 2 trades have been incorporated on a prospective basis. This treatment was adopted primarily as a result of the data necessary to produce the loss development tables not being migrated over on acquisition of the portfolios as it was not requested or received and as a result does not exist within Armour Re's data systems.

Disclosures of Incurred and Paid Loss Development, IBNR, Claims Counts and Payout Percentages

The loss development tables disclosed below set forth our historic incurred and paid loss development by accident year through December 31, 2018, as well as the cumulative number of reported claims, IBNR balances, and other supplementary information.

For each acquisition year for which loss development tables have been provided below, the disclosure approach and format adopted reflects the following:

- The incurred loss development tables include both reported case reserves and IBNR liabilities, as well as cumulative paid losses;
- Both the incurred and cumulative paid loss development tables include allocated LAE (i.e. claims handling costs allocated to specific individual claims) but exclude unallocated LAE (i.e. the costs associated with internal claims staff and third party administrators);
- The amounts relating to the increase (reduction) in provisions for unallocated LAE are excluded from the loss development tables;
- The amounts included within the loss development tables as well as the historical average annual percentage payout ratios as of December 31, 2018, are presented as supplementary information and are therefore unaudited; and
- The IBNR reserves included within each incurred loss development table by accident year, reflect the net IBNR recorded as of December 31, 2018, including expected development on reported losses.

Reported claim counts, on a cumulative basis, are provided as supplemental information to each incurred loss development table by accident year. The claims frequency includes open and closed claims by accident year at the claimant level. Reported claims that are closed without a payment are included within our cumulative number of reported claims because we typically incur claim adjustment expenses on them prior to their closure.

The following tables present the incurred and paid claims development for the acquired portfolios as at December 31, 2018:

Portfolio 1

Incurred Claims and ALAE

Accident Year	Period / Year Ended December 31,		December 31, 2018	
	2017	2018	Total IBNR	Cumulative Number of Reported Claims
	(Unaudited)			
2017	$ 199,178,427	$ 136,367,865	$ 36,487,376	202,006
2018		6,630,415	1,238,468	1,611
Total		$ 142,998,280	$ 37,725,844	203,617

Cumulative Paid Claims and ALAE

Accident Year	Period / Year Ended December 31,	
	2017	2018
	(Unaudited)	
2017	$ —	$ 48,893,015
2018		3,418,774
Total		$ 52,311,789
Total reserve for losses and ALAE		$ 90,686,491

Portfolio 2

Incurred Claims and ALAE

Accident Year	Year Ended December 31,	December 31, 2018	
	2018	Total IBNR	Cumulative Number of Reported Claims
2018	$ 13,327,374	$ 831,363	288,404

Cumulative Paid Claims and ALAE

Accident Year	Year Ended December 31,
	2018
2018	$ 4,837,028
Total reserve for losses and ALAE	$ 8,490,346

The reconciliation of the net incurred and paid claims development tables to the reserve for losses and loss adjustment expenses in the balance sheet is as follows:

	December 31, 2018
Reserve for losses and ALAE	
Portfolio 1	$ 90,686,491
Portfolio 2	8,490,346
Total reserve for losses and ALAE	99,176,837
Unallocated loss adjustment expenses	6,481,028
Total reserve for losses and loss adjustment expenses	$ 105,657,865

Claims duration

The following table is presented as supplementary information and presents the Company's historical average annual percentage payout of loss and loss adjustment expenses incurred, net by age, as at December 31, 2018:

	Average Annual Percentage Payout of Incurred Losses by Age									
	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
	(Unaudited)									
Portfolio 1	—%	36.6%	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Portfolio 2	36.3%	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A

7. DEFERRED CHARGE

The following table presents a reconciliation of the beginning and ending deferred charge for the year ended December 31, 2018 and the period from November 20, 2017 (date of incorporation) to December 31, 2017:

	2018	2017
Balance as at January 1, (2017 : November 20,)	$ 26,645,370	$ —
Acquired during the year [1]	(6,944,950)	26,645,370
Amortization	(7,896,338)	—
Balance as at December 31,	$ 11,804,082	$ 26,645,370

[1] As disclosed in Note 1 - "Description of Business", during 2018 the deferred charge relating to Portfolio 1 was reduced in line with the change in the Co-Investment Ratio.

Deferred charge assets relate to retroactive reinsurance policies providing indemnification of losses and LAE with respect to past loss events. At the inception of a contract, a deferred charge asset is recorded for the excess, if any, of the estimated ultimate losses payable over the premiums received. These amounts relate to the Portfolio 1 transaction, described in Note 3 - "Significant New Business."

8. SHARE CAPITAL AND ADDITIONAL PAID-IN CAPITAL

As at December 31, 2018 and 2017, the authorized share capital of the Company was $10.0 million divided into 10,000,000 shares of par value of $1.00 each. As at December 31, 2018 and 2017, the issued and fully paid share capital of the Company was 120,000 ordinary shares of par value $1.00 per share.

As at December 31, 2018, the Company recorded $132.7 million (2017: $122.1 million) in additional paid-in capital relating to contributions from its parent for purposes of funding significant new business transactions and operational expenses. As disclosed in Note 1 - "Description of Business", during 2018 the additional paid-in capital relating to Portfolio 1 was reduced in line with the change in the Co-Investment Ratio. This reduction was partially offset by an increase in additional paid-in capital relating to Portfolio 2, discussed in Note 3 - "Significant New Business."

9. TAXATION

The Company is incorporated under the laws of Bermuda and under Bermuda law is not required to pay taxes in Bermuda based upon income or capital gains. The Company, under the Exempted Undertakings Tax Protection Act of 1966, is protected against any legislation that may be enacted in Bermuda which would impose any tax on profits, income, or gain until March 31, 2035.

10. RELATED PARTY TRANSACTIONS

PC Re II

See Note 1 - "Description of Business" and Note 3 - "Significant New Business" for discussion related to the Co-Investment Framework Agreement and transactions between Armour Re and PC Re II. During the year ended December 31, 2018, PC Re II ceded $9.2 million of net premiums earned, $4.0 million of net investment income, $0.9 million of net realized and change in net unrealized losses, $4.9 million of net losses and LAE, $5.1 million of other reinsurance expenses and $0.2 million of general and administrative expenses to Armour Re.

Our balance sheet as at December 31, 2018 primarily includes the following balances related to transactions with PC Re II: premiums receivable of $5.4 million (2017: $193.7 million), funds withheld of $193.0 million (2017: $nil), due from cedant of $3.7 million (2017: $nil), deferred charge assets of 11.8 million (2017: 26.6 million), other assets of $0.1 million (2017: $nil), reserve for losses and loss adjustment expenses of $105.7 million (2017: $209.9 million), unearned premiums of $0.1 million (2017: $10.4 million), due to cedant of $4.8 million (2017: $nil) and other liabilities of $1.7 million (2017: $nil).

Armour Group

At December 31, 2018, the Company had a balance payable to its parent of $1.1 million which is payable on demand and is non-interest bearing. At December 31, 2017, the Company had a receivable from its parent of $122.1 million in relation to its capital contribution.

Armour Risk Management Inc. and Armour Risk Management Limited (collectively "Armour Risk"), wholly-owned subsidiaries of Armour Group Ltd., entered into administrative services agreements with PC Re II agreeing to act as claims administrator for Portfolios 1 and 2. Under the QS Agreements with PC Re II, Armour Re's share of the fees paid to Armour Risk for services provided were $3.0 million during the year ended December 31, 2018.

11. DIVIDEND RESTRICTIONS AND STATUTORY FINANCIAL INFORMATION

The Company is registered under the Insurance Act 1978 of Bermuda and related regulations, as amended (the "Insurance Act"). The Insurance Act imposes certain solvency and liquidity standards and auditing and reporting requirements and grants the Bermuda Monetary Authority ("BMA") powers to supervise, investigate, require information and the production of documents and intervene in the affairs of insurance companies.

The Insurance Act requires that we maintain certain solvency and liquidity standards. The minimum liquidity ratio requires that the value of relevant assets not be less than 75% of the amount of relevant liabilities. The minimum solvency margin ("MSM"), which varies depending on the class of the insurer, is determined as a percentage of either net reserves for losses and LAE or premiums or pursuant to a risk-based capital measure. We are required to maintain a minimum statutory capital and surplus (Enhanced Capital Requirement or "ECR") at least equal to the greater of a MSM or the Bermuda Solvency Capital Requirement ("BSCR"). The BSCR is calculated based on a standardized risk-based capital model.

The Company prepares its statutory financial statements in conformity with statutory accounting practices prescribed or permitted by the BMA. The statutory financial statements may vary materially from statements prepared in accordance with U.S. GAAP.

Statutory capital and surplus as at December 31, 2018 and 2017 and statutory net income for the year ended December 31, 2018 and for the period from November 20, 2017 to December 31, 2017 were as follows:

	Statutory Capital and Surplus				Statutory Net Income (Loss)	
	Required		Actual		Actual	
	December 31,		December 31,		Year / Period Ended December 31,	
	2018	2017	2018	2017	2018	2017
Armour Re	$ 36,101,000	$ 88,897,000	$ 126,135,000	$ 89,896,000	$ 4,413,476	$ (236,048)

We would be prohibited from declaring or paying any dividends if we were in breach of our minimum solvency margin (which is a function of outstanding losses) or liquidity ratio (which is a function of relevant assets) or if the declaration or payment of such dividends would cause it to fail to meet such margin or ratio. In addition, we would be prohibited, without the prior approval of the BMA, from reducing by 15% or more our total statutory capital as set out in its previous year's statutory financial statements.

As at December 31, 2018 and 2017, the Company exceeded its enhanced capital and liquidity requirements.

12. COMMITMENTS AND CONTINGENCIES

Concentration of Credit Risk

We believe that there are no significant concentrations of credit risk associated with our portfolio of cash and cash equivalents.

We are also subject to credit risk in relation to funds withheld. Under funds withheld arrangements, the reinsured company has retained funds that would otherwise have been remitted to us. The funds may be placed into trust or subject to other security arrangements. The funds withheld balance is credited with investment income and losses payable are deducted. The investment returns of funds held are recognized in net investment income. Funds withheld upon which we receive the underlying portfolio economics are disclosed in the notes to the financial statements as funds withheld - directly managed. We are subject to credit risk if the reinsured company is unable to honor the value of the funds withheld balances, such as in the event of insolvency. However, we generally have the contractual ability to offset any shortfall in the payment of the funds withheld balances with amounts owed by us to the reinsured for losses payable and other amounts contractually due. We routinely monitor the creditworthiness of the reinsured company with whom we have funds withheld arrangements. At December 31, 2018, we had a significant concentration of $193.0 million in funds withheld from PC Re II as described in Note 10 - "Related Party Transactions".

Legal Proceedings

We are, from time to time, involved in various legal proceedings in the ordinary course of business, including litigation and arbitration regarding claims. Estimated losses relating to claims arising in the ordinary course of business, including the anticipated outcome of any pending arbitration or litigation are included in the liability for losses and LAE in our balance sheets. We do not believe that the resolution of any currently pending legal proceedings, either individually or taken as a whole, will have a material effect on our business, results of operations or financial condition. We anticipate that, similar to the rest of the reinsurance industry, we will continue to be subject to litigation and arbitration proceedings in the ordinary course of business.

13. SUBSEQUENT EVENTS

The Company has completed its subsequent events evaluation for the period subsequent to the balance sheet date December 31, 2018 through to April 30, 2019, the date these financial statements would be issued and, except for the items described in Note 3 - "Significant New Business," concluded that there are no subsequent events requiring recognition or disclosure.