

**AEL Re Bermuda Ltd.**

Financial Statements

Period from Inception (December 2, 2021) through December 31, 2021

(With Report of Independent Auditors Thereon)

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## **Report of Independent Auditors**

The Audit Committee and Board of Directors  
AEL Re Bermuda Ltd.

### **Opinion**

We have audited the financial statements of AEL Re Bermuda Ltd. (the Company) which comprise the balance sheet as of December 31, 2021, and the related statements of operations and comprehensive loss, changes in stockholder's equity and cash flows for the period from December 2, 2021 (date of inception) to December 31, 2021, and the related notes (collectively referred to as the "financial statements").

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Company at December 31, 2021, and the results of its operations and its cash flows for the period from December 2, 2021 (Date of inception) to December 31, 2021 then ended in accordance with accounting principles generally accepted in the United States of America.

### **Basis for Opinion**

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of the Company and to meet our other ethical responsibilities in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### **Responsibilities of Management 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, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free of material misstatement, whether due to fraud or error.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the Company's ability to continue as a going concern for one year after the date that the financial statements are available to be issued.

### **Auditor's Responsibilities for the Audit of the Financial Statements**

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free of material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood

that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit 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, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about the Company's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control-related matters that we identified during the audit.

*Ernst & Young LLP*

Des Moines, Iowa  
July 5, 2022

**AEL Re Bermuda Ltd.**

**Balance Sheet**

**December 31, 2021**

**(Dollars in thousands, except share and per share data)**

	<b>2021</b>
<b>Assets</b>	
Cash and cash equivalents	\$ 180,000
Funds withheld asset	4,222,531
Deferred tax asset	56
Other assets, at fair value (related party: \$72,458)	72,458
Total assets	\$ 4,475,045
<b>Liabilities and Stockholder's Equity</b>	
<b>Liabilities:</b>	
Policy benefit reserves	\$ 4,220,065
Notes payable to Parent	165,000
Reinsurance payable to affiliate	9,924
Other liabilities (related party: \$144)	267
Total liabilities	4,395,256
<b>Stockholder's equity:</b>	
Common stock, par value \$1 per share, 250,000 shares authorized; issued and outstanding	250
Additional paid-in capital	79,750
Retained deficit	(211)
Total stockholder's equity	79,789
Total liabilities and stockholder's equity	\$ 4,475,045

See accompanying notes to financial statements.

**AEL Re Bermuda Ltd.**  
**Statement of Operations and Comprehensive Loss**  
**Period ended December 31, 2021**  
**(Dollars in thousands)**

	<b>2021</b>
Revenues:	
Total revenues	\$ —
Benefits and expenses:	
Other operating costs and expenses	267
Total benefits and expenses	267
Income before income taxes	(267)
Income tax benefit	(56)
Net loss	(211)
Other comprehensive income	—
Comprehensive loss	\$ (211)

See accompanying notes to financial statements.

**AEL Re Bermuda Ltd.**

**Statement of Changes in Stockholder's Equity**

**Period ended December 31, 2021**

**(Dollars in thousands)**

	<b>Common stock</b>	<b>Additional paid-in capital</b>	<b>Retained deficit</b>	<b>Total stockholder's equity</b>
Balance at December 2, 2021	\$ —	\$ —	\$ —	\$ —
Net loss	—	—	(211)	(211)
Issuance of common stock	250	79,750	—	80,000
Balance at December 31, 2021	<u>\$ 250</u>	<u>\$ 79,750</u>	<u>\$ (211)</u>	<u>\$ 79,789</u>

See accompanying notes to financial statements.

**AEL Re Bermuda Ltd.**  
**Statement of Cash Flows**  
**Period ended December 31, 2021**  
**(Dollars in thousands)**

	<b>2021</b>
Operating activities:	
Net loss	\$ (211)
Adjustments to reconcile net loss to net cash used in operating activities:	
Deferred income tax benefit	(56)
Change in policy benefit reserves	4,220,065
Change in funds withheld asset	(4,222,531)
Change in reinsurance payables to affiliate	9,924
Change in other assets	(72,458)
Change in other liabilities	267
Net cash used in operating activities	(65,000)
Financing activities:	
Proceeds from issuance of common stock	80,000
Proceeds from notes payable to Parent	165,000
Net cash provided by financing activities	245,000
Increase in cash and cash equivalents	180,000
Cash and cash equivalents at beginning of period	—
Cash and cash equivalents at end of year	\$ 180,000
Supplemental disclosures of cash flow information	
Cash paid during the year for:	
Income taxes	\$ —
Interest expense	—

See accompanying notes to financial statements.



**AEL Re Bermuda Ltd.**

**Notes to Financial Statements**

**December 31, 2021**

**1. Nature of Operations and Summary of Significant Accounting Policies**

***Nature of Operations***

AEL Re Bermuda Ltd. ("we", "our" or the "Company"), a Bermuda exempted Company, is a wholly-owned subsidiary of American Equity Investment Life Holding Company (the "Parent" or the "Holding Company"). The Company was incorporated on December 2, 2021 and is a Class C licensed reinsurer. The Company's primary business operation is reinsurance of life and annuity insurance contracts. On December 31, 2021 the Company executed its first agreement to reinsure life and annuity contracts that were issued by American Equity Investment Life Insurance Company ("AEILIC"), which is a subsidiary of the Parent. The Company may execute other similar reinsurance transactions with AEILIC.

***Basis of Presentation***

We have prepared the financial statements in accordance with accounting principles generally accepted in the United States of America ("GAAP").

***Use of Estimates***

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant estimates and assumptions are utilized in the calculation of policy benefit reserves, including the fair value of embedded derivatives in fixed index annuity contracts, valuation of the other assets, valuation of funds withheld assets, and valuation allowances on deferred tax assets. A description of each critical estimate is incorporated within the discussion of the related accounting policies which follow. It is reasonably possible that actual experience could differ from the estimates and assumptions utilized.

***Summary of Significant Accounting Policies***

**Policy Benefit Reserves**

Policy benefit reserves for fixed index annuities with returns linked to the performance of a specified market index are equal to the sum of the fair value of the embedded derivatives and the host (or guaranteed) component of the contracts. The host value is established at inception of the contract and accreted over the policy's life at a constant rate of interest. Future policy benefit reserves for fixed rate index annuities earning a fixed rate of interest and other deferred annuity products are computed under a retrospective deposit method and represent policy account balances before applicable surrender charges. For the period ended December 31, 2021, interest crediting rates for these products ranged from 1.00% to 4.00%.

Policy benefit reserves includes the impacts of the AEILIC reinsurance agreement where we assumed investment contracts as of December 31, 2021. See Note 5 - Reinsurance for further discussion on the reinsurance impacts.

**Funds Withheld Asset**

The funds withheld asset represents a receivable for amounts contractually withheld by AEILIC in accordance with the coinsurance with funds withheld reinsurance agreement with AEILIC. The investments supporting the funds withheld asset primarily consists of fixed maturity securities and are legally owned by the ceding company, however, all economic rights and obligations on the investments accrue to the Company.

The fair values of the fixed maturity securities that support the funds withheld asset are generally based on quoted market prices in active markets, when available, or for those fixed maturity securities not actively traded, yield data and other factors relating to instruments or securities with similar characteristics are used. See Note 2 - Fair Value of Financial Instruments for more information on the determination of fair value.

Reinsurance agreements written on a funds withheld basis contain embedded derivatives. The right to receive the total return on the assets supporting the funds withheld represent a total return swap. The fair value of the embedded derivative on funds withheld agreements is computed as the unrealized gain (loss) on the underlying assets and will be included in the funds withheld asset on the balance sheet for assumed agreements. The embedded derivative value was zero at the inception of the reinsurance agreement on December 31, 2021.

**Other Assets**

Other assets includes amounts due from AEILIC representing call options purchased by AEILIC to fund fixed index annuity credits related to the reinsured business. We have elected the fair value option for this asset. We reinsure fixed index annuity products that guarantee the return

## **AEL Re Bermuda Ltd.**

### **Notes to Financial Statements**

**December 31, 2021**

of principal to the policyholder and credit interest based on a percentage of the gain in a specified market index. When fixed index annuity deposits are received, a portion of the deposit is used by AEILIC to purchase derivatives consisting of call options on the applicable market indices to fund the index credits due to fixed index annuity policyholders. We are entitled to the proceeds on those call options when such call options expire. Substantially all such call options are one year options purchased to match the funding requirements of the underlying policies. On the respective anniversary dates of the index policies, the index used to compute the index credit is reset and AEILIC purchases new call options on our behalf to fund the next index credit. AEILIC manages the cost of these purchases through the terms of the reinsured fixed index annuities, which permit AEILIC to change caps, participation rates, and/or asset fees, subject to guaranteed minimums on each policy's anniversary date. By adjusting caps, participation rates, or asset fees, AEILIC can generally manage option costs except in cases where the contractual features would prevent further modifications. The receivable is recognized in the balance sheet at fair value of the underlying derivatives. Changes in fair value will be recognized immediately in operations.

AEILIC's strategy attempts to mitigate any potential risk of loss due to the nonperformance of the counterparties to these call options through a regular monitoring process which evaluates the program's effectiveness. AEILIC does not purchase call options that would require payment or collateral to another institution and the call options do not contain counterparty credit-risk-related contingent features. AEILIC is exposed to risk of loss in the event of nonperformance by the counterparties and, accordingly, AEILIC purchases our option contracts from multiple counterparties and evaluate the creditworthiness of all counterparties prior to purchase of the contracts. All non-exchange traded options have been purchased from nationally recognized financial institutions with a Standard and Poor's credit rating of A- or higher at the time of purchase and the maximum credit exposure to any single counterparty is subject to concentration limits. AEILIC also has credit support agreements that allows it to request the counterparty to provide collateral when the fair value of the exposure to the counterparty exceeds specified amounts.

#### **Cash and Cash Equivalents**

We consider all highly liquid debt instruments purchased with an original maturity of three months or less to be cash equivalents.

#### **Deferred Income Taxes**

Deferred income tax assets or liabilities are computed based on the temporary differences between the financial statement and income tax bases of assets and liabilities using the enacted marginal tax rate. The effect on deferred income tax assets and liabilities resulting from a change in the enacted marginal tax rate is recognized in income in the period that includes the enactment date. Deferred income tax expenses or benefits are based on the changes in the asset or liability from period to period. Deferred income tax assets are subject to ongoing evaluation of whether such assets will more likely than not be realized. The realization of deferred income tax assets primarily depends on generating future taxable income during the periods in which temporary differences become deductible. Deferred income tax assets are reduced by a valuation allowance if, based on the weight of available evidence, it is more likely than not that some portion or all of the deferred tax asset will not be realized. In making such a determination, all available positive and negative evidence, including scheduled reversals of deferred tax liabilities, projected future taxable income, tax planning strategies and recent financial operations, is considered. The realization of deferred income tax assets related to unrealized losses on available-for-sale fixed maturity securities is also based upon our intent and ability to hold those securities for a period of time sufficient to allow for a recovery in fair value and not realize the unrealized loss. See *Note 6 - Income Taxes* for more information on deferred income taxes.

The Company along with its affiliates are included in American Equity Investment Life Holding company's U.S. consolidated income tax return. The Company has made the Internal Revenue Code section 953(d) election to be taxed as a U.S. domestic corporation for purposes of U.S. corporate tax.

#### **Recognition of Premium Revenues and Costs**

Revenues for assumed annuity products include surrender charges assessed against policyholder account balances in future periods. Interest sensitive and index product benefits related to annuity products include interest credited or index credits to policyholder account balances pursuant to accounting by insurance companies for certain long-duration contracts. The change in fair value of the embedded derivatives for fixed index annuities equals the change in the difference between policy benefit reserves for fixed index annuities computed under the derivative accounting standard and the long-duration contracts accounting standard at each balance sheet date. As the effective date of the coinsurance with funds withheld reinsurance agreement with AEILIC was December 31, 2021, no such revenues or costs were recognized during 2021.

#### **Other Comprehensive Loss**

Other comprehensive income (loss) includes all changes in stockholders' equity during a period except those resulting from investments by and distributions to stockholders. Other comprehensive income (loss) excludes net realized investment gains (losses) included in net income which merely represents transfers from unrealized to realized gains and losses.

**AEL Re Bermuda Ltd.**

**Notes to Financial Statements**

**December 31, 2021**

**New Accounting Pronouncements**

In August 2018, the Financial Accounting Standards Board ("FASB") issued an Accounting Standards Update ("ASU") that revises certain aspects of the measurement models and disclosure requirements for long duration insurance and investment contracts. The FASB's objective in issuing this ASU is to improve, simplify, and enhance the accounting for long-duration contracts. The revisions include updating cash flow assumptions in the calculation of the liability for traditional life products, introducing the term 'market risk benefit' ("MRB") and requiring all contract features meeting the definition of an MRB to be measured at fair value and simplifying the method used to amortize deferred policy acquisition costs and deferred sales inducements to a constant basis over the expected term of the related contracts rather than based on actual and estimated gross profits and enhancing disclosure requirements. The ASU is effective for the Company on January 1, 2025. Early adoption of this ASU is permitted. We are in the process of evaluating the impact this guidance will have on our financial statements.

**2. Fair Values of Financial Instruments**

The following sets forth a comparison of the carrying amounts and fair values of our financial instruments:

	2021	
	Carrying Amount	Fair Value
	(Dollars in thousands)	
Assets		
Other assets	\$ 72,458	\$ 72,458
Cash and cash equivalents	180,000	180,000
Funds withheld asset	4,222,531	4,222,531
Liabilities		
Policy benefit reserves	4,043,205	3,785,390
Notes payable to Parent	165,000	165,000

Fair value is the price that would be received to sell an asset or paid to transfer a liability (exit price) in an orderly transaction between market participants at the measurement date. The objective of a fair value measurement is to determine that price for each financial instrument at each measurement date. We meet this objective using various methods of valuation that include market, income and cost approaches.

We categorize our financial instruments into three levels of fair value hierarchy based on the priority of inputs used in determining fair value. The hierarchy defines the highest priority inputs (Level 1) as quoted prices in active markets for identical assets or liabilities. The lowest priority inputs (Level 3) are our own assumptions about what a market participant would use in determining fair value such as estimated future cash flows. In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, a financial instrument's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement. Our assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the financial instrument. We categorize financial assets and liabilities recorded at fair value in the balance sheets as follows:

- Level 1 - Quoted prices are available in active markets for identical financial instruments as of the reporting date. We do not adjust the quoted price for these financial instruments, even in situations where we hold a large position and a sale could reasonably impact the quoted price.
- Level 2 - Quoted prices in active markets for similar financial instruments, quoted prices for identical or similar financial instruments in markets that are not active; and models and other valuation methodologies using inputs other than quoted prices that are observable.
- Level 3 - Models and other valuation methodologies using significant inputs that are unobservable for financial instruments and include situations where there is little, if any, market activity for the financial instrument. The inputs into the determination of fair value require significant management judgment or estimation. Financial instruments that are included in Level 3 are securities for which no market activity or data exists and for which we used discounted expected future cash flows with our own assumptions about what a market participant would use in determining fair value.

Transfers of securities among the levels occur at times and depend on the type of inputs used to determine fair value of each security.

AEL Re Bermuda Ltd.

Notes to Financial Statements

December 31, 2021

Our assets and liabilities which are measured at fair value on a recurring basis as of December 31, 2021 are presented below based on the fair value hierarchy levels:

	Total Fair Value	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
(Dollars in thousands)				
<b>December 31, 2021</b>				
<b>Assets</b>				
Other assets	\$ 72,458	\$ —	\$ 72,458	\$ —
Cash and cash equivalents	180,000	180,000	—	—
Funds withheld asset <sup>1</sup>	4,187,285	75,451	4,111,834	—
	<u>\$ 4,439,743</u>	<u>\$ 255,451</u>	<u>\$ 4,184,292</u>	<u>\$ —</u>
<b>Liabilities</b>				
Fixed index annuities - embedded derivatives	\$ 651,146	\$ —	\$ —	\$ 651,146

The following methods and assumptions were used in estimating the fair values of financial instruments during the period presented in these financial statements.

**Funds withheld asset**

The funds withheld asset represents a receivable for assets contractually withheld by the ceding company. The funds withheld asset is valued at fair market value on the effective date of the reinsurance agreement. The assets withheld at December 31, 2021, which is the effective date of the reinsurance agreement includes cash and cash equivalents, fixed maturity securities and the accrued investment income on the securities. The cash and cash equivalents are reported at historical cost which approximates fair value due to the nature of the assets. Accrued investment income is calculated based upon contractual terms which approximates the fair value. The fixed maturity securities included in the funds withheld asset that are in an active and orderly market are determined by utilizing independent pricing services. The independent pricing services incorporate a variety of observable market data in their valuation techniques, including:

- reported trading prices,
- benchmark yields,
- broker-dealer quotes,
- benchmark securities,
- bids and offers,
- credit ratings,
- relative credit information, and
- other reference data.

The independent pricing services also take into account perceived market movements and sector news, as well as a security's terms and conditions, including any features specific to that issue that may influence risk and marketability. Depending on the security, the priority of the use of observable market inputs may change as some observable market inputs may not be relevant or additional inputs may be necessary. The independent pricing services provide quoted market prices when available. Quoted prices are not always available due to market inactivity. When quoted market prices are not available, the third parties use yield data and other factors relating to instruments or securities with similar characteristics to determine fair value for securities that are not actively traded. We generally obtain one value from our primary external pricing service. In situations where a price is not available from this service, we may obtain quotes or prices from additional parties as needed. Market indices of similar rated asset class spreads are considered for valuations and broker indications of similar securities are compared. Inputs used by the broker include market information, such as yield data and other factors relating to instruments or securities with similar characteristics. Valuations and quotes obtained from third party commercial pricing services are non-binding and do not represent quotes on which one may execute the disposition of the assets.

<sup>1</sup> Excludes accrued interest income of \$35,246

**AEL Re Bermuda Ltd.**

**Notes to Financial Statements**

**December 31, 2021**

We validate external valuations at least quarterly through a combination of procedures that include the evaluation of methodologies used by the pricing services, comparison of the prices to a secondary pricing source, analytical reviews and performance analysis of the prices against trends, and maintenance of a securities watch list. Additionally, as needed we utilize discounted cash flow models or perform independent valuations on a case-by-case basis using inputs and assumptions similar to those used by the pricing services. Although we do identify differences from time to time as a result of these validation procedures, we did not make any significant adjustments as of December 31, 2021.

The coinsurance with funds withheld reinsurance agreement gives rise to an embedded derivative which is bifurcated from the host contract and carried at fair value within the funds withheld asset on the balance sheet. The fair value of the embedded derivative on the funds withheld asset is based on the unrealized gain (loss) on the underlying assets included within the funds withheld account.

***Other assets***

The fair value of the other assets represents the fair value of call options allocated to the Company from AEILIC. We elected the fair value option due to the nature of the financial instrument. The valuation is based upon the amount of cash that we would receive to settle the derivative instrument on the reporting date. These amounts are determined using industry accepted valuation models and are adjusted for the nonperformance risk of each counterparty net of any collateral held. Inputs include market volatility and risk free interest rates and are used in income valuation techniques in arriving at a fair value for each option contract. The nonperformance risk for each counterparty is based upon its credit default swap rate. We have no performance obligations related to the call options purchased by AEILIC to fund the assumed fixed index annuity policy liabilities.

***Cash and cash equivalents***

Amounts reported in the balance sheets for these instruments are reported at their historical cost which approximates fair value due to the nature of the assets assigned to this category.

***Policy benefit reserves***

The fair values of the liabilities under contracts not involving significant mortality or morbidity risks (deferred annuities), are stated at the cost we would incur to extinguish the liability (i.e., the cash surrender value) as these contracts are generally issued without an annuitization date. Policy benefit reserves for fixed rate deferred annuities are not measured at fair value on a recurring basis. All of the fair values presented within this category fall within Level 3 of the fair value hierarchy as most of the inputs are unobservable market data.

***Notes payable to Parent***

The fair value of our note payable to affiliate is equal to the initial principal balance as the note was entered into on December 31, 2021. The note payable to affiliate is categorized as Level 2 within the fair value hierarchy. Notes payable are not remeasured at fair value on a recurring basis.

***Fixed index annuities - embedded derivatives***

We estimate the fair value of the embedded derivative component of our fixed index annuity policy benefit reserves at each valuation date by (i) projecting policy contract values and minimum guaranteed contract values over the expected lives of the contracts and (ii) discounting the excess of the projected contract value amounts at the applicable risk free interest rates adjusted for our nonperformance risk related to those liabilities. The projections of policy contract values are based on our best estimate assumptions for future policy growth and future policy decrements. Our best estimate assumptions for future policy growth include assumptions for the expected index credit on the next policy anniversary date which are derived from the fair values of the underlying call options purchased to fund such index credits and the expected costs of annual call options we will purchase in the future to fund index credits beyond the next policy anniversary. The projections of minimum guaranteed contract values include the same best estimate assumptions for policy decrements as were used to project policy contract values.

Within this determination we have the following significant unobservable inputs: 1) the expected cost of annual call options we will purchase in the future to fund index credits beyond the next policy anniversary and 2) our best estimates for future policy decrements, primarily lapse, partial withdrawal and mortality rates.

**AEL Re Bermuda Ltd.**

**Notes to Financial Statements**

**December 31, 2021**

The following summarizes the the unobservable inputs for the embedded derivatives of fixed indexed annuities:

Unobservable Input	Weighted Average			Impact of an increase in the input on fair value
	Duration 11 - 15	Duration 16 - 20	Duration 20 +	
Cost of future annual call options	2.1%	2.1%	2.1%	Increase
Lapse Rate	8.20%	8.90%	4.90%	Decrease
Partial Withdrawal Rates	3.10%	1.30%	—%	Decrease
Mortality	3.40%	4.20%	6.40%	Decrease

The expected cost of annual call options is based on estimated long-term account value growth and a historical review of our actual option costs. Our best estimate assumptions for lapse, partial withdrawal and mortality rates are based on our actual experience and our outlook as to future expectations for such assumptions. These assumptions are reviewed on a quarterly basis and are updated as our experience develops and/or as future expectations change.

Lapse rates are generally expected to increase as surrender charge percentages decrease for policies without a lifetime income benefit rider. Lapse expectations reflect a significant increase in the year in which the surrender charge period on a contract ends.

The following table provides a reconciliation of the beginning and ending balances for our Level 3 liabilities, which are measured at fair value on a recurring basis using significant unobservable inputs for the period ended December 31, 2021:

	Period Ended December 31, 2021 (Dollars in thousands)
<b>Fixed index annuities - embedded derivatives</b>	
Beginning balance	\$ —
Reserve assumed related to in-force reinsurance	651,146
Ending balance	<u>\$ 651,146</u>

The change in fair value of the embedded derivatives will be included in Change in fair value of embedded derivatives within the statement of operations.

Certain derivatives embedded in our fixed index annuity contracts are our most significant financial instrument measured at fair value that are categorized as Level 3 in the fair value hierarchy. The contractual obligations for future annual index credits within our fixed index annuity contracts are treated as a "series of embedded derivatives" over the expected life of the applicable contracts. We estimate the fair value of these embedded derivatives at each valuation date by the method described above under **fixed index annuities - embedded derivatives**. The projections of minimum guaranteed contract values include the same best estimate assumptions for policy decrements as were used to project policy contract values.

The most sensitive assumption in determining policy liabilities for fixed index annuities is the rates used to discount the excess projected contract values. As indicated above, the discount rate reflects our nonperformance risk. If the discount rates used to discount the excess projected contract values at December 31, 2021, were to increase, the fair value of the embedded derivatives would decrease.

**AEL Re Bermuda Ltd.**

**Notes to Financial Statements**

**December 31, 2021**

**3. Funds Withheld Asset**

The funds withheld asset represents a receivable for amounts contractually withheld by the ceding company in accordance with the coinsurance with funds withheld reinsurance agreement in which we are the reinsurer. Generally, assets at statutory carrying value equal to statutory reserves are withheld and legally owned by the ceding company.

At December 31, 2021, the following summarizes the underlying investment composition of the funds withheld asset.

	<u>Carried at Fair Value</u>
<b>December 31, 2021</b>	
Bonds:	
United States municipalities, states and territories	\$ 423,190
Corporate securities	2,768,834
Commercial mortgage backed securities	338,076
Other asset backed securities	581,734
Cash and Cash equivalents	75,451
Accrued investment income	35,246
	<u>\$ 4,222,531</u>

All of the assets in the funds withheld account were rated investment grade as of December 31, 2021. A summary of our funds withheld asset by Nationally Recognized Statistical Rating Organizations ("NRSRO") ratings is as follows:

	<u>December 31,</u>	
	<u>2021</u>	
<u>Rating Agency Rating</u>	<u>Fair Value</u>	<u>Percent of Funds Withheld Asset</u>
	<u>(Dollars in thousands)</u>	
Aaa/Aa/A	\$ 2,716,493	64.9 %
Baa	1,470,792	35.1 %
Total investment grade <sup>2</sup>	<u>\$ 4,187,285</u>	<u>100.0 %</u>

***Concentrations of Financial and Capital Markets Risk***

The company is exposed to financial and capital market risk, including changes in interest rates and credit spreads which could have an adverse effect on the Company's financial options, results of operations, and liquidity. A rise in interest rates, in the absence of other countervailing changes, will have an adverse impact on the recorded fair value of the Company's fund withheld asset. If long term interest rates rise dramatically within a short period of time, certain of the Company's reinsured products may be exposed to disintermediation risk. Disintermediation risk refers to the risk that policyholders may surrender their contracts in a rising interest rate environment, requiring the Company to liquidate assets earlier than expected. This risk is mitigated to some extent by surrender charge protection provided by the products reinsured by the Company.

<sup>2</sup> Excludes accrued investment income of \$35,246.

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**Notes to Financial Statements**

**December 31, 2021**

**4. Derivative Instruments**

None of our derivatives qualify for hedge accounting, thus, any change in the fair value of the derivatives is recognized immediately in the statements of operations. The fair value of our derivative instruments, including derivative instruments embedded in fixed index annuity contracts, presented in the balance sheet are as follows:

	<b>December 31,</b>
	<b>2021</b>
	<b>(Dollars in thousands)</b>
<b>Liabilities</b>	
<b>Policy benefit reserves - annuity products</b>	
Fixed index annuities - embedded derivatives	\$ 651,146
	<u>\$ 651,146</u>

The future index credits on the reinsured fixed index annuities are treated as a "series of embedded derivatives" over the expected life of the applicable contract. AEILIC does not purchase call options to fund the index liabilities which may arise after the next policy anniversary date. We must value both the call options and the related forward embedded options in the policies at fair value.

**5. Reinsurance**

Effective December 31, 2021, we entered into a coinsurance funds withheld agreement with AEILIC, an affiliated life insurance company, to reinsure a closed block of fixed rate deferred and fixed indexed annuities. The effects of the reinsurance agreement are recorded as investment contracts. The following summarizes the agreement at inception:

	<b>Period Ended December 31,</b>
	<b>2021</b>
	<b>(Dollars in thousands)</b>
Assets received	\$ 4,285,065
Less: Liabilities assumed	4,043,205
Ceding commission paid	65,000
Net cost of reinsurance <sup>3</sup>	<u>\$ 176,860</u>

The net cost of reinsurance will be amortized over the life of the reinsurance agreement.

<sup>3</sup> Included within policy benefit reserves on the balance sheet



**AEL Re Bermuda Ltd.**  
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**6. Income Taxes**

Our income tax expense as presented in the state of operations consisted of the following:

	<u>Period Ended December 31,</u> <u>2021</u> <u>(Dollars in thousands)</u>
Statements of operations:	
Current income tax expense/(benefit)	\$ —
Deferred income tax expense/(benefit)	(56)
Total income tax expense/(benefit) included in statement of operations	<u>\$ (56)</u>

Income tax expense in the statements of operations is equal to the applicable statutory federal income tax rate of 21% for the year ended December 31, 2021.

Deferred income tax assets or liabilities are established for temporary differences between the financial reporting amounts and tax bases of assets and liabilities that will result in deductible or taxable amounts, respectively, in future years. The tax effects of temporary differences that give rise to the deferred tax assets and liabilities at December 31, 2021, are as follows:

	<u>December 31,</u> <u>2021</u> <u>(Dollars in thousands)</u>
Deferred income tax assets:	
Policy benefit reserves	\$ 55,666
Net operating loss carryforwards	4,983
Other	54
Gross deferred tax assets	<u>60,703</u>
Deferred income tax liabilities:	
Funds withheld reinsurance adjustments	(50,360)
Other	(10,287)
Gross deferred tax liabilities	<u>(60,647)</u>
Net deferred income tax asset	<u>\$ 56</u>

Realization of our deferred income tax assets is more likely than not based on expectations as to our future taxable income and considering all other available evidence, both positive and negative. Therefore, no valuation allowance against deferred income tax assets has been established as of December 31, 2021.

There were no material income tax contingencies requiring recognition in our financial statements as of December 31, 2021. Our tax returns are subject to audit by various federal, state and local tax authorities. The Company's income tax returns are subject to examination by the IRS and state tax authorities, generally for three years after they are due or filed, whichever is later.

At December 31, 2021, the Company has \$23.7 million of net operating loss carryforwards for federal income tax purposes.

**7. Notes payable to Parent**

On December 31, 2021, the Company entered into an intercompany credit facility agreement with the Holding Company. The agreement provided a credit facility of \$165 million which the Company could draw all or in part from time to time. The unpaid principal amounts, regardless of when advances are made, are due on December 31, 2026 or earlier at our request. Interest accrues daily at the secured overnight financing rate for such business day plus 150 bps. On December 31, 2021, the Company borrowed \$165 million under the credit facility agreement.

## **8. Commitments and Contingencies**

The Company may be from time to time subject to legal proceedings and claims in the ordinary course of business. In accordance with applicable accounting guidelines, we establish an accrued liability for litigation and regulatory matters when those matters present loss contingencies that are both probable and estimable. As a litigation or regulatory matter is developing we, in conjunction with outside counsel, evaluate on an ongoing basis whether the matter presents a loss contingency that meets conditions indicating the need for accrual and/or disclosure, and if not, the matter will continue to be monitored for further developments. If and when the loss contingency related to litigation or regulatory matters is deemed to be both probable and estimable, we will establish an accrued liability with respect to that matter and will continue to monitor the matter for further developments that may affect the amount of the accrued liability.

There can be no assurance that any pending or future litigation will not have a material adverse effect on our business, financial condition, or results of operations.

## **9. Related party transactions**

The Company has an Investment Advisory Agreement with the Holding Company. Under this agreement, the Company pays a quarterly fee in arrears based on an annual rate of 0.25% on the first \$100 million plus 0.20% on the amount in excess of \$100 million of the fair value of the average quarterly net asset value. As the Company commenced operations on December 31, 2021, no fees were incurred under this agreement in 2021.

The Company has a Management Services Agreement with the Holding Company and its subsidiaries. Under this agreement, certain services may be performed by Holding Company subsidiaries on behalf of AEL Re Bermuda. The services included in the Management Services Agreement include general, administrative, and other services including support services, treasury services, tax services, legal affairs, accounting/books and records, financial statements/periodic reports, financial services, property management, borrowing documentation, government approvals, investor relations, human resources, strategic planning and business development, corporate finance services, record services, procurement, travel related services, and use of office space, technical services, and intellectual property and licenses. In exchange for providing these functions, the Company reimburses AEILIC for costs as calculated in accordance with the Management Services Agreement.

As of December 31, 2021, the Company owed AEILIC \$144 thousand related to the expenses incurred in 2021 on its behalf.

## **10. Common Shares**

The Company has one class of common stock which represents 100% of the Company's total voting shares. All issued shares are beneficially owned by and were transferred to the Holding Company by AEILIC.

## **11. Statutory Requirements**

The Company is licensed by the Bermuda Monetary Authority ("BMA") as a Class C insurer and is subject to the Insurance Act 1978, as amended ("Bermuda Insurance Act") and regulations promulgated thereunder. The BMA implemented the Economic Balance Sheet ("EBS") framework into the Bermuda Solvency and Capital Requirement ("BSCR") which was granted equivalency to the European Union's Directive (2009/138/EC) ("Solvency II"). Under this framework a Class C insurer must produce three sets of financial statements

1. GAAP Financial Statements – Financial statements prepared in accordance with an internationally recognized comprehensive basis of accounting. We have elected to prepare US GAAP Financial statements. These financial statements form the basis for the Statutory Financial Statements and the Economic Balance Sheet.
2. Statutory Financial Statements (SFS) – Equal to the US GAAP financial statements adjusted to eliminate non-admitted assets including goodwill and other similar intangible assets not considered admissible for solvency purposes, and certain assets and liabilities that are generally off-balance sheet under general purpose reporting. These include items such as guarantees and other instruments that do not relate to the insurer's own insurance contracts. The SFS is also adjusted based upon directions or permitted practices issued by the BMA.
3. Economic Balance Sheet (EBS) – A balance sheet where assets are recorded based on US GAAP fair values and insurance reserves are based on technical provisions comprised of a best estimate liability plus a risk margin. The best estimate liability may be calculated by applying the standard approach or the scenario approach.

Based upon the Bermuda Insurance Act, the Company is required to maintain minimum statutory capital and surplus to meet the minimum margin of solvency ("MMS") and minimum economic statutory capital and surplus (EBS capital and surplus) to meet the Enhanced Capital Requirement ("ECR"). The MMS is equal to the greater of \$500,000 or 1.5% of total statutory assets. The ECR is calculated using the risk-based capital model where risk factor charges are applied to the EBS. As of December 31, 2021 the Company met the minimum requirements.

**AEL Re Bermuda Ltd.**

**Notes to Financial Statements**

**December 31, 2021**

For the SFS, we received the following permitted practices from the BMA:

1. We are permitted to remove the effect of the Financial Accounting Standard 133 DIG Issue B36 ("DIG B36") which creates an embedded derivative on the funds withheld assets;
2. We are permitted to record fixed income securities at amortized cost and therefore not recognize unrealized gains and/or losses on those investments; and
3. We are permitted to calculate reserves on assumed fixed index annuity contracts based on policyholder account values.

The following represents the effect of the permitted practices to the statutory financial statements:

	<b>Period Ended December 31,</b>
	<b>2021</b>
	<b>(Dollars in thousands)</b>
Increase (decrease) to capital and surplus due to permitted practices	\$ —
Increase (decrease) to statutory net income due to permitted practices	—

The Company cannot pay dividends:

1. Which exceed 25% of our total statutory capital and surplus in our prior year SFS unless at least seven days before payment of the dividend we file with the Authority an affidavit signed: a) by at least two directors (one of whom must be a director resident in Bermuda), and b) by the Company's principal representative in Bermuda which states that in the opinion of those signing, declaration of those dividends has not caused the Company to fail to meet its relevant margins. A copy of every affidavit filed shall be kept by the Authority in its office and shall be open to the inspection by the public.
2. During any financial year if it would cause the Company to fail to meet its relevant margins.
3. If the Company fails to meet the relevant margins on the last day of any financial year, without the approval of the authority during the next year.

**12. Subsequent Events**

The Company has evaluated subsequent events through July 5, 2022, which is the date the financial statements were available to be issued.