



April 28, 2023

## Report of Independent Auditors

To the Board of Directors of HCC Reinsurance Company Limited

### Opinions

We have audited the accompanying condensed consolidated financial statements of HCC Reinsurance Company Limited and its subsidiaries (the "Company"), which comprise the condensed consolidated balance sheets and condensed consolidated statements of capital and surplus as of December 31, 2022 and 2021, and the related condensed consolidated statements of income for the years then ended, including the related notes (collectively referred to as the "condensed consolidated financial statements").

#### *Unmodified opinion on regulatory basis of accounting*

In our opinion, the accompanying condensed consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2022 and 2021, and the results of its operations for the years then ended in accordance with the financial reporting provisions of the Insurance Act 1978, amendments thereto and the Insurance Account Rules 2016 with respect to condensed general purpose financial statements (the "Legislation").

#### *Adverse opinion on U.S. generally accepted accounting principles*

In our opinion, because of the significance of the matter discussed in the *Basis for adverse opinion on U.S. generally accepted accounting principles* section of our report, the accompanying condensed consolidated financial statements do not present fairly, in accordance with accounting principles generally accepted in the United States of America, the financial position of the Company as of December 31, 2022 and 2021, or the results of its operations for the years then ended.

### Basis for Opinions

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (US GAAS). Our responsibilities under those standards are further described in the *Auditors' responsibilities for the audit of the condensed consolidated 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 opinions.

#### *Basis for adverse opinion on U.S. generally accepted accounting principles*

As described in Note 3 to the condensed consolidated financial statements, the condensed consolidated financial statements are prepared by the Company on the basis of the financial reporting provisions of the Legislation, which is a basis of accounting other than accounting principles generally accepted in the United States of America, to meet the requirements of the Bermuda Monetary Authority.

The effects on the condensed consolidated financial statements of the variances between the regulatory basis of accounting described in Note 3 and accounting principles generally accepted in the United States of America, although not reasonably determinable, are presumed to be material and pervasive.



## **Responsibilities of management for the condensed consolidated financial statements**

Management is responsible for the preparation and fair presentation of the condensed consolidated financial statements in accordance with the financial reporting provisions of the Legislation. Management is also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the condensed consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the condensed consolidated 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 the condensed consolidated financial statements are available to be issued.

## **Auditors' responsibilities for the audit of the condensed consolidated financial statements**

Our objectives are to obtain reasonable assurance about whether the condensed consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' 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 US 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 judgement made by a reasonable user based on the condensed consolidated financial statements.

In performing an audit in accordance with US GAAS, we:

- Exercise professional judgement and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the condensed consolidated 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 condensed consolidated financial statements.
- Obtain an understanding of internal controls 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 condensed consolidated financial statements.
- Conclude whether, in our judgement, 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.

*PricewaterhouseCoopers Ltd.*

**Chartered Professional Accountants**

# CONDENSED CONSOLIDATED BALANCE SHEET

Consolidated HCC Reinsurance Company Limited and Subsidiary

As at December 31, 2022

expressed in ['000s] United States Dollars

LINE No.		2022	2021
1.	CASH AND CASH EQUIVALENTS	48,206	43,813
2.	QUOTED INVESTMENTS:		
(a)	Bonds and Debentures		
i.	Held to maturity	-	-
ii.	Other	296,412	295,443
(b)	Total Bonds and Debentures	296,412	295,443
(c)	Equities		
i.	Common stocks	-	-
ii.	Preferred stocks	-	-
iii.	Mutual funds	-	-
(d)	Total equities	-	-
(e)	Other quoted investments	-	-
(f)	Total quoted investments	296,412	295,443
3.	UNQUOTED INVESTMENTS:		
(a)	Bonds and Debentures		
i.	Held to maturity	-	-
ii.	Other	-	-
(b)	Total Bonds and Debentures	-	-
(c)	Equities		
i.	Common stocks	-	-
ii.	Preferred stocks	-	-
iii.	Mutual funds	-	-
(d)	Total equities	-	-
(e)	Other unquoted investments	-	-
(f)	Total unquoted investments	-	-
4.	INVESTMENTS IN AND ADVANCES TO AFFILIATES		
(a)	Unregulated entities that conduct ancillary services	-	-
(b)	Unregulated non-financial operating entities	-	-
(c)	Unregulated financial operating entities	-	-
(d)	Regulated non-insurance financial operating entities	-	-
(e)	Regulated insurance financial operating entities	-	-
(f)	Total investments in affiliates	-	-
(g)	Advances to affiliates	-	-
(h)	Total investments in and advances to affiliates	-	-
5.	INVESTMENTS IN MORTGAGE LOANS ON REAL ESTATE:		
(a)	First liens	1,033	1,238
(b)	Other than first liens	-	-
(c)	Total investments in mortgage loans on real estate	1,033	1,238
6.	POLICY LOANS	-	-
7.	REAL ESTATE:		
(a)	Occupied by the company (less encumbrances)	-	-
(b)	Other properties (less encumbrances)	-	-
(c)	Total real estate	-	-
8.	COLLATERAL LOANS	-	-
9.	INVESTMENT INCOME DUE AND ACCRUED	1,696	1,490
10.	ACCOUNTS AND PREMIUMS RECEIVABLE:		
(a)	In course of collection	4,048	10,988
(b)	Deferred - not yet due	58,359	51,208
(c)	Receivables from retrocessional contracts	-	-
(d)	Total accounts and premiums receivable	62,407	62,196
11.	REINSURANCE BALANCES RECEIVABLE:		
(a)	Foreign affiliates	-	-
(b)	Domestic affiliates	-	-
(c)	Pools & associations	-	-
(d)	All other insurers	-	-
(e)	Total reinsurance balance receivable	-	-
12.	FUNDS HELD BY CEDING REINSURERS	36,623	27,243
13.	SUNDRY ASSETS:		
(a)	Derivative instruments	-	5,260

## Consolidated HCC Reinsurance Company Limited and Subsidiary

expressed in ['000s]

United States Dollars

LINE No.		2022	2021
(b)	Segregated accounts companies - long-term business - variable annuities	-	
(c)	Segregated accounts companies - long-term business - other	-	
(d)	Segregated accounts companies - general business	-	
(e)	Deposit assets	-	
(f)	Deferred acquisition costs	33,356	34,480
(g)	Net receivables for investments sold	-	
(h)	Airplanes	109,526	69,163
(i)	Income tax receivable & deferred income taxes	5,391	6,667
(j)	Intercompany receivable	3,163	-
(k)	Total sundry assets	151,436	115,570
14.	LETTERS OF CREDIT, GUARANTEES AND OTHER INSTRUMENTS		
(a)	Letters of credit	-	
(b)	Guarantees	-	
(c)	Other instruments	-	
(e)	Total letters of credit, guarantees and other instruments	-	-
15.	TOTAL	597,813	546,993
	<b>TOTAL INSURANCE RESERVES, OTHER LIABILITIES AND STATUTORY CAPITAL AND SURPLUS</b>		
16.	UNEARNED PREMIUM RESERVE		
(a)	Gross unearned premium reserves	148,463	161,620
(b)	Less: Ceded unearned premium reserve		
i.	Foreign affiliates	9,022	9,924
ii.	Domestic affiliates	-	-
iii.	Pools & associations	-	-
iv.	All other insurers	23,641	26,870
(c)	Total ceded unearned premium reserve	32,663	36,794
(d)	Net unearned premium reserve	115,800	124,826
17.	LOSS AND LOSS EXPENSE PROVISIONS:		
(a)	Gross loss and loss expense provisions	164,052	96,051
(b)	Less : Reinsurance recoverable balance		
i.	Foreign affiliates	5,780	7,850
ii.	Domestic affiliates	-	-
iii.	Pools & associations	-	-
iv.	All other reinsurers	500	14,534
(c)	Total reinsurance recoverable balance	6,280	22,384
(d)	Net loss and loss expense provisions	157,772	73,667
18.	OTHER GENERAL BUSINESS INSURANCE RESERVES	-	
19.	TOTAL GENERAL BUSINESS INSURANCE RESERVES	273,572	198,493
	<b>LONG-TERM BUSINESS INSURANCE RESERVES</b>		
20.	RESERVE FOR REPORTED CLAIMS	-	
21.	RESERVE FOR UNREPORTED CLAIMS	-	
22.	POLICY RESERVES - LIFE	-	
23.	POLICY RESERVES - ACCIDENT AND HEALTH	-	
24.	POLICYHOLDERS' FUNDS ON DEPOSIT	-	
25.	LIABILITY FOR FUTURE POLICYHOLDERS' DIVIDENDS	-	
26.	OTHER LONG-TERM BUSINESS INSURANCE RESERVES	-	
27.	TOTAL LONG-TERM BUSINESS INSURANCE RESERVES		
(a)	Total Gross Long-Term Business Insurance Reserves	-	-
(b)	Less: Reinsurance recoverable balance on long-term business		
(i)	Foreign Affiliates	-	
(ii)	Domestic Affiliates	-	
(iii)	Pools and Associations	-	
(iv)	All Other Insurers	-	
(c)	Total Reinsurance Recoverable Balance	-	-
(d)	<b>Total Net Long-Term Business Insurance Reserves</b>	-	-

# CONDENSED CONSOLIDATED BALANCE SHEET

Consolidated HCC Reinsurance Company Limited and Subsidiary

As at December 31, 2022

expressed in ['000s] United States Dollars

LINE No.

## OTHER LIABILITIES

28. INSURANCE AND REINSURANCE BALANCES PAYABLE

11,314

3,583

29. COMMISSIONS, EXPENSES, FEES AND TAXES PAYABLE

12,571

18,807

30. LOANS AND NOTES PAYABLE

-

-

31. (a) INCOME TAXES PAYABLE

666

-

(b) DEFERRED INCOME TAXES

-

3,239

32. AMOUNTS DUE TO AFFILIATES

333

6,469

33. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

181

59

34. FUNDS HELD UNDER REINSURANCE CONTRACTS:

-

-

35. DIVIDENDS PAYABLE

-

-

36. SUNDRY LIABILITIES:

(a) Derivative instruments

-

-

(b) Segregated accounts companies

-

-

(c) Deposit liabilities

-

-

(d) Net payable for investments purchased

5,042

9,717

(e) Holdback and earnout liability

10,739

10,131

(f) Reinsurers' portion of airplane

-

10,070

(g) Other deferred revenue

375

-

(h) Total sundry liabilities

16,156

29,918

37. LETTERS OF CREDIT, GUARANTEES AND OTHER INSTRUMENTS:

(a) Letters of credit

-

-

(b) Guarantees

-

-

(c) Other instruments

-

-

(d) Total letters of credit, guarantees and other instruments

-

-

38. TOTAL OTHER LIABILITIES

41,221

62,075

39. TOTAL INSURANCE RESERVES AND OTHER LIABILITIES

314,793

260,568

## CAPITAL AND SURPLUS

40. TOTAL CAPITAL AND SURPLUS

283,020

286,425

41. TOTAL

597,813

546,993

# CONDENSED CONSOLIDATED STATEMENT OF INCOME

Consolidated HCC Reinsurance Company Limited and Subsidiary  
As at December 31, 2022  
expressed in ['000s] United States Dollars

LINE No.		2022	2021
	<b>GENERAL BUSINESS UNDERWRITING INCOME</b>		
1.	GROSS PREMIUMS WRITTEN		
	(a) Direct gross premiums written	15,098	1,937
	(b) Assumed gross premiums written	35,533	46,097
	(c) Total gross premiums written	50,631	48,034
2.	REINSURANCE PREMIUMS CEDED	2,351	605
3.	NET PREMIUMS WRITTEN	48,280	47,429
4.	INCREASE (DECREASE) IN UNEARNED PREMIUMS	9,027	3,480
5.	NET PREMIUMS EARNED	57,307	50,909
6.	OTHER INSURANCE INCOME	25	-
7.	TOTAL GENERAL BUSINESS UNDERWRITING INCOME	57,332	50,909
	<b>GENERAL BUSINESS UNDERWRITING EXPENSES</b>		
8.	NET LOSSES INCURRED AND NET LOSS EXPENSES INCURRED	14,877	19,632
9.	COMMISSIONS AND BROKERAGE	14,729	10,933
10.	TOTAL GENERAL BUSINESS UNDERWRITING EXPENSES	29,606	30,565
11.	<b>NET UNDERWRITING PROFIT (LOSS) - GENERAL BUSINESS</b>	27,726	20,344
	<b>LONG-TERM BUSINESS INCOME</b>		
12.	GROSS PREMIUMS AND OTHER CONSIDERATIONS:		
	(a) Direct gross premiums and other considerations	-	-
	(b) Assumed gross premiums and other considerations	-	-
	(c) Total gross premiums and other considerations	-	-
13.	PREMIUMS CEDED	-	-
14.	NET PREMIUMS AND OTHER CONSIDERATIONS:		
	(a) Life	-	-
	(b) Annuities	-	-
	(c) Accident and health	-	-
	(d) Total net premiums and other considerations	-	-
15.	OTHER INSURANCE INCOME	-	-
16.	TOTAL LONG-TERM BUSINESS INCOME	-	-
	<b>LONG-TERM BUSINESS DEDUCTIONS AND EXPENSES</b>		
17.	CLAIMS - LIFE	-	-
18.	POLICYHOLDERS' DIVIDENDS	-	-
19.	SURRENDERS	-	-
20.	MATURITIES	-	-
21.	ANNUITIES	-	-
22.	ACCIDENT AND HEALTH BENEFITS	-	-
23.	COMMISSIONS	-	-
24.	OTHER	-	-
25.	TOTAL LONG-TERM BUSINESS DEDUCTIONS AND EXPENSES	-	-
26.	INCREASE (DECREASE) IN POLICY RESERVES (ACTUARIAL LIABILITIES):		
	(a) Life	-	-
	(b) Annuities	-	-
	(c) Accident and health	-	-
	(d) Total increase (decrease) in policy reserves	-	-
27.	TOTAL LONG-TERM BUSINESS EXPENSES	-	-
28.	<b>NET UNDERWRITING PROFIT (LOSS) - LONG-TERM BUSINESS</b>	-	-

**CONDENSED CONSOLIDATED STATEMENT OF INCOME**

Consolidated HCC Reinsurance Company Limited and Subsidiary

As at December 31, 2022

expressed in ['000s] United States Dollars

LINE No.		2022	2021
29.	<b>COMBINED NET UNDERWRITING RESULTS BEFORE THE UNDERNOTED ITEMS</b>	<u>27,726</u>	<u>20,344</u>
	<b>UNDERNOTED ITEMS</b>		
30.	COMBINED OPERATING EXPENSE		
	(a) General and administration	<u>5,188</u>	<u>1,845</u>
	(b) Personnel cost	<u>-</u>	<u>-</u>
	(c) Other	<u>-</u>	<u>1</u>
	(d) Total combined operating expenses	<u>5,188</u>	<u>1,846</u>
31.	COMBINED INVESTMENT INCOME - NET	<u>9,380</u>	<u>6,085</u>
32.	COMBINED OTHER INCOME (DEDUCTIONS)	<u>2,484</u>	<u>8,506</u>
33.	COMBINED INCOME BEFORE TAXES	<u>34,402</u>	<u>33,089</u>
34.	COMBINED INCOME TAXES (IF APPLICABLE):		
	(a) Current	<u>7,334</u>	<u>6,278</u>
	(b) Deferred	<u>(202)</u>	<u>684</u>
	(c) Total	<u>7,132</u>	<u>6,962</u>
35.	COMBINED INCOME BEFORE REALIZED GAINS (LOSSES)	27,270	26,127
36.	COMBINED REALIZED GAINS (LOSSES)	<u>1,032</u>	<u>1,632</u>
37.	COMBINED INTEREST CHARGES	<u>-</u>	<u>-</u>
38.	NET INCOME	<u>28,302</u>	<u>27,759</u>



# CONDENSED CONSOLIDATED STATEMENT OF CAPITAL AND SURPLUS

Consolidated HCC Reinsurance Company Limited and Subsidiary

As at December 31, 2022

expressed in ['000s] United States Dollars

LINE No.		2022	2021
1.	<b>CAPITAL:</b>		
(a)	Capital Stock		
	(i) Common Shares	120	120
	authorized 120,000 shares of par		
	value \$ 1.000 each issued and		
	fully paid 120,000 shares		
	(ii)		
	(A) Preferred shares:		
	authorized _____ shares of par		
	value _____ each issued and		
	fully paid _____ shares		
	aggregate liquidation value for —		
	2022 _____		
	2021 _____		
	(B) Preferred shares issued by a subsidiary:		
	authorized _____ shares of par		
	value _____ each issued and		
	fully paid _____ shares		
	aggregate liquidation value for —		
	2022 _____		
	2021 _____		
	(iii) Treasury Shares		
	repurchased _____ shares of par		
	value _____ each issued		
(b)	Contributed surplus	183,865	183,865
(c)	Any other fixed capital		
	(i) Hybrid capital instruments	-	-
	(ii) Guarantees and others	-	-
	(iii) Total any other fixed capital	-	-
(d)	Total Capital	183,985	183,985
2.	<b>SURPLUS:</b>		
(a)	Surplus - Beginning of Year	102,440	79,190
(b)	Add: Income for the year	28,302	27,759
(c)	Less: Dividends paid and payable	-	-
(d)	Add (Deduct) change in unrealized appreciation (depreciation) of investments	(31,707)	(4,509)
(e)	Add (Deduct) change in any other surplus	-	-
(f)	Surplus - End of Year	99,035	102,440
3.	<b>MINORITY INTEREST</b>		
4.	<b>TOTAL CAPITAL AND SURPLUS</b>	283,020	286,425

**HCC REINSURANCE COMPANY LIMITED**  
**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE YEARS ENDED DECEMBER 31, 2022 and 2021**  
**(expressed in United States Dollars)**

**PART I**

1. HCC Reinsurance Company Ltd. (the Company) is a wholly-owned subsidiary of HCC Insurance Holdings, Inc. (HCC), a Delaware Corporation, which is ultimately owned by Tokio Marine Holdings, Inc. (TMHD), a Japanese Corporation. The Company holds a Class 3A license under the Insurance Act of 1978. The condensed consolidated financial statements include the consolidation of the following subsidiaries:

- HCC Re Agency Ltd., a Bermuda corporation, and wholly-owned subsidiary of the Company
- WGIL1-North Mobile LLC, a wholly-owned subsidiary established in January 2021 to hold a mortgage loan received as salvage.
- WGIL 2-MLK LLC, a wholly-owned subsidiary established in January 2021 to hold a mortgage loan received as salvage. The property securing the mortgage was sold, and the mortgage repaid, in December 2021.
- TMHCC\_EMIR2 LLC, a wholly-owned subsidiary established in September 2021 to hold an airplane received as salvage.
- TMHCC\_Air 1 LLC, a wholly-owned subsidiary established in March 2022 to hold an airplane received as salvage.
- TMHCC\_Air 2 LLC, a wholly-owned subsidiary established in April 2022 to hold an airplane received as salvage.

2. The Company primarily writes business directly and assumes business from affiliated insurance companies. The Company primarily writes medium to large limit aircraft and commercial real estate residual value, title, mortgage guarantee and excess tax insurance policies. Additionally, the Company writes crisis management and eminent domain policies.

3. The condensed consolidated general purpose financial statements have been prepared in conformity with the financial reporting provisions of the Insurance Act 1978, amendments thereto and the Insurance Account Rules 2016 with respect to Condensed General Purpose Financial Statements (the "Legislation"). The condensed consolidated general purpose financial statements are based upon accounting principles generally accepted in the United States of America ("US GAAP"), but are in accordance with reporting requirements of the Legislation, which varies in certain respects from US GAAP. The more significant variances are as follows:

- A consolidated statement of cash flow is not included;
- A consolidated statement of comprehensive income is not included;
- The presentation and classification of financial statement line items is in accordance with Schedules IX and XI of the Insurance Account Rules 2016 and differ from the expected presentation and classification under US GAAP.
- The notes included in the condensed consolidated general purpose financial statements have been prepared in accordance with Schedule X of the Insurance Account Rules 2016 and exclude certain information required under US GAAP.

The condensed consolidated general purpose financial statements include the accounts of the Company and its subsidiaries. All significant intercompany transactions and balances have been eliminated.

**4. SIGNIFICANT ACCOUNTING POLICIES**

**a. Premiums earned and reinsurance premiums**

The Company recognizes in current earned income the portion of the premium that provides insurance protection in the period. For the majority of the insurance policies, the Company recognizes premium, net of reinsurance, on a pro rata basis over the term of the related contract. Premiums for commercial title insurance policies are recognized in earnings on the effective date of the contract.

**b. Loss and loss expenses provisions**

Loss and loss expenses provisions are based on undiscounted estimates of payments to be made for reported losses, net of reinsurance. Estimates for reported losses are based on all available information, including reports received from ceding companies on assumed business. Estimates for incurred but not reported losses are based on the Company's and industry experience. While management believes that amounts included in the accompanying financial statements are adequate, such estimates may be more or less than the amounts ultimately paid when the claims are settled. The estimates are continually reviewed and any changes are reflected in current operations.

**c. Foreign currency translation**

Assets and liabilities recorded in foreign currencies are revalued at current exchange rates. Revenue and expenses recorded in foreign currencies are revalued based on the effective date of the original transaction. Gains and losses from foreign currency transactions are included in combined other income (deductions).

**d. Reinsurance**

All reinsurance amounts are calculated and recorded in a manner consistent with the underlying reinsured contracts. The Company reviews the collectability of the reinsurance recoverables and has recorded no allowance for uncollectible reinsurance. The estimate utilized to calculate the allowance is subject to change and this could affect the level of reserve required. Certain reinsurance agreements allow for reinsurance premiums to be held by the ceding entity as prescribed in the contract. The Company records these applicable reinsurance transactions as funds held by ceding reinsurers.

**e. Cash and cash equivalents**

The Company considers all certificates of deposit with original maturities of three months or less and money market funds to be cash equivalents. Cash and cash equivalents include restricted fiduciary funds of \$10,739,000 as of December 31, 2022 and \$9,421,000 as of December 31, 2021 held in accordance with an acquisition agreement. The corresponding liability is included with sundry liabilities.

**f. Investments**

Bonds and debentures are classified as available for sale and reported at fair value. There were no restricted bonds and debentures as of either December 31, 2022 or December 31, 2021.

A security has an impairment loss when its fair value is less than its cost or amortized cost at the balance sheet date. The Company evaluated impaired securities for possible other-than-temporary impairment loss at each quarter end, considering various factors including: 1) amount by which the security's fair value is less than its cost, 2) length of time the security has been impaired, 3) whether the Company intended to sell the security, 4) if it is more likely than not that the Company will sell the security before recovery of its amortized cost basis, 5) whether the impairment is due to an issuer-specific event, credit issues or change in market interest rates, 6) the security's credit rating and any recent downgrades and 7) stress testing of expected cash flows under various scenarios. The Company recognized no other-than-temporary impairment losses in 2022 and 2021.

Realized investment gains or losses are determined based on specific identification and included in earnings on the trade date. If a structured security fails to pay the full amount of expected principal, the Company recognizes the unpaid amount as a realized loss in the period due and permanently reduces the security's cost basis. If a security or loan is non-income producing, it is placed on a non-accrual status and any cash proceeds are applied as a reduction of principal when received.

**HCC REINSURANCE COMPANY LIMITED**  
**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE YEARS ENDED DECEMBER 31, 2022 and 2021**  
**(expressed in United States Dollars)**

PART I (con't)

g. Derivative instruments

During 2004, the Company assumed a transaction whose underlying exposure is the value of a portfolio of home mortgages over a 22 year period as measured by the Halifax Price Index. The fair value of this contract was reported as a derivative asset of \$5,260,000 as of December 31, 2021. The transaction went off risk in April 2022, at which time the Company received \$4,971,000, resulting in a \$289,000 loss.

5. THE BASIS OF RECOGNITION OF THE FOLLOWING ITEMS ARE:

- a. Premiums - The Company recognizes in current earned income the portion of the premium that provides insurance protection in the period. For the majority of the insurance policies, the Company recognizes premium, net of reinsurance, on a pro rata basis over the term of the related contract. Premiums for commercial title insurance policies are recognized in earnings on the effective date of the contract.
- b. Investment income is earned on the accrual basis of accounting.
- c. Commission Income - The Company does not have any commission income.

6. TRANSLATION METHODS

Assets and liabilities recorded in foreign currencies are revalued at current exchange rates. Revenue and expenses recorded in foreign currencies are revalued based on the effective date of the original transaction. Translation gains and losses are recorded in combined other income (deductions) on the condensed consolidated statement of income.

7. FOREIGN CURRENCY CONTROL RESTRICTIONS - N/A

8. CONTINGENCIES

From time to time, the Company has ceded certain risks to other companies. Although the ceding of reinsurance does not discharge the primary insurer from liability to its policyholder, the Company participates in such agreements for the purpose of limiting its loss exposure and diversifying its business.

A contingent liability is present with respect to the Company's reinsurance which would become an actual liability to the extent that any reinsuring company failed to meet its obligations to the Company. However, in the opinion of management, with the experience of the companies involved, there is no exposure related to this scenario.

9. COMPANY DEFAULT - N/A

10. ARREARS DIVIDENDS - N/A

11. LOANS - N/A

12. RETIREMENT BENEFITS - N/A

13. INVESTMENTS - FAIR VALUE MEASUREMENTS

Items measured and reported at fair value by Levels 1, 2 and 3:

Level 1 - Inputs are based on quoted prices in active markets for identical instruments.

Level 2 - Inputs are based on observable market data (other than quoted prices), or are corroborated by observable market data. This category includes fixed maturity securities.

Level 3 - Inputs are observable and are not corroborated by market data.

The following tables summarize the Company's assets and liabilities measured and reported at fair value:

December 31, 2022:

Type of Financial Instrument	Level 1	Level 2	Level 3	Total
Fixed maturity securities				
Fixed income securities of states, municipalities, and political subdivisions	\$ -	\$ 13,826,000	\$ -	\$ 13,826,000
Special purpose revenue bonds of states, municipalities, and political subdivisions	-	61,065,000	-	61,065,000
Corporate securities	-	24,858,000	-	24,858,000
Residential mortgage-backed securities	-	121,464,000	-	121,464,000
Commercial mortgage-backed securities	-	25,259,000	-	25,259,000
Asset-backed securities	-	49,940,000	-	49,940,000
Total fixed maturity securities	-	296,412,000	-	296,412,000
Cash and short-term investments	31,987,000	13,908,000	-	45,895,000
Total assets measured at fair value	\$ 31,987,000	\$ 310,320,000	\$ -	\$ 342,307,000
Holdback liability	-	10,739,000	-	10,739,000
Total liabilities measured at fair value	\$ -	\$ 10,739,000	\$ -	\$ 10,739,000

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December 31, 2021:

Type of Financial Instrument	Level 1	Level 2	Level 3	Total
<b>Fixed maturity securities</b>				
Fixed income securities of states, municipalities, and political subdivisions	\$ -	\$ 16,251,000	\$ -	\$ 16,251,000
Special purpose revenue bonds of states, municipalities, and political subdivisions	-	70,575,000	-	70,575,000
Corporate securities	-	23,226,000	-	23,226,000
Residential mortgage-backed securities	-	106,359,000	-	106,359,000
Commercial mortgage-backed securities	-	27,334,000	-	27,334,000
Asset-backed securities	-	51,698,000	-	51,698,000
Total fixed maturity securities	-	295,443,000	-	295,443,000
Cash and short-term investments	18,068,000	19,865,000	-	37,933,000
<b>Total assets measured at fair value</b>	<b>\$ 18,068,000</b>	<b>\$ 315,308,000</b>	<b>\$ -</b>	<b>\$ 333,376,000</b>
<b>Earnout liability</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 710,000</b>	<b>\$ 710,000</b>
<b>Holdback liability</b>	<b>-</b>	<b>9,421,000</b>	<b>-</b>	<b>9,421,000</b>
<b>Total liabilities measured at fair value</b>	<b>\$ -</b>	<b>\$ 9,421,000</b>	<b>\$ 710,000</b>	<b>\$ 10,131,000</b>

**14. INVESTMENTS - CONTRACTUAL MATURITY**

The value of bonds at December 31, 2022 and 2021 by contractual maturity are shown below. Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

Fixed maturity securities:	<u>2022</u>	<u>2021</u>
Due within one year	\$ 839,000	\$ -
Due after one year through five years	16,399,000	10,396,000
Due after five years through ten years	52,581,000	44,419,000
Due after ten years	226,593,000	240,628,000
<b>Total fixed maturity securities</b>	<b>\$ 296,412,000</b>	<b>\$ 295,443,000</b>

**15. RELATED PARTY TRANSACTIONS**

Certain management functions are performed by affiliates of the Company, HCC Service Co. and HCC Service Co. UK Branch. Costs incurred by these affiliates are allocated to the Company pursuant to an intercompany cost allocation agreement. Additional intercompany payables are related to the timing of receivable and payables that arise in the course of business.

The Company reported amounts receivable/(payable) to affiliates as follows at December 31:

	<u>2022</u>	<u>2021</u>
HCC International Insurance Co.	\$ (204,000)	\$ (181,000)
HCC Service Company, Inc.	(128,000)	(105,000)
HCC Service Co. UK	(1,000)	(2,000)
HCCIG Agency	-	(181,000)
Houston Casualty Co.	3,157,000	-
U.S. Specialty Insurance Co.	6,000	(6,000,000)
<b>Total</b>	<b>\$ 2,830,000</b>	<b>\$ (6,469,000)</b>

At December 31, 2022, the Company had commissions payable of \$12,561,000 due to HCC Indemnity Guaranty, an affiliated company, and \$10,000 to unaffiliated companies.

The Company had accounts and premium receivable due from affiliated companies of \$25,280,000 and \$33,979,000 at December 31, 2022 and December 31, 2021, respectively.

The Company has provided cash balances to affiliated ceding reinsurers as collateral against future losses incurred by the ceding reinsurers. Total funds held by ceding reinsurers at December 31, 2022 and 2021 were \$36,623,000 and \$27,243,000, respectively.

**16. SUBSEQUENT EVENTS**

None

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17. ADDITIONAL DISCLOSURES

**Mortgage Insurance Collateral**

The Company reinsures excess losses on a portfolio of mortgage insurance policies that originated between 2009 and 2022. The Company provides collateral consisting of bonds, cash and accrued interest income of \$81,752,000 and \$70,520,000 at December 31, 2022 and December 31, 2021, respectively.

**Assumed Australian Surety and Credit**

On June 30, 2020, the Company entered into three reinsurance agreements with an affiliated Australian insurance company, Tokio Marine and Nichido Fire Insurance Co., Limited – Australian Branch (TMNFA). The agreements provided stop-loss coverage to certain subsidiaries of TMNFA for a block of surety and credit business written through June 20, 2020 (the “Australian Surety and Credit” business). On June 30, 2020, the company recorded \$9.7 million of written premium and \$28.9 million of loss and loss expense provision. The Company also received a \$90.0 million capital contribution to provide additional capital support for any losses associated with the Australian Surety and Credit business. The loss and loss adjustment expense provision recorded on June 30, 2020, was based on an Actuarial Valuation Report performed by Taylor Fry, an unaffiliated actuary, as of March 31, 2020, and included significant losses related to the impact of COVID-19 on the Australian Surety and Credit business. We continued to monitor the exposure to COVID-19 and increased the loss and loss adjustment expense provision to \$109.7 million at December 31, 2020, based on an updated report from Taylor Fry. The Company commuted these reinsurance agreements with TMNFA on March 26, 2021 without significant additional loss.

PART II

A. 1 (a) CAPITAL STOCK

Authorized, issued and fully paid - 120,000 shares of US \$1.00 par value each - \$120,000.

1 (b) CONTRIBUTED SURPLUS

The Company received a \$10,000,000 capital contribution from HCC Insurance Holdings during 2021.

2 (c) DIVIDENDS PAID AND PAYABLE

The Company did not pay any dividends during 2022 or 2021.

PART III

1. CASH AND CASH EQUIVALENTS

Cash consists of cash in banks and short term money market accounts. The Company considers all certificates of deposit with original maturities of three months or less and money market funds to be cash equivalents. Cash and cash equivalents include restricted fiduciary funds of \$10,739,000 as of December 31, 2022 and \$9,421,000 as of December 31, 2021 held in accordance with an acquisition agreement. The corresponding liability is included with sundry liabilities.

The Company reinsures excess losses on a portfolio of mortgage insurance policies that originated between 2009 and 2022. The Company provides collateral consisting of cash of \$3,769,000 and \$10,844,000 at December 31, 2022 and December 31, 2021, respectively.

2. QUOTED INVESTMENTS

Bonds and debentures are reported at fair value. Bonds and debentures are available for sale, but may be sold if the Company can reinvest the proceeds at a higher effective yield or if the security has credit-related issues. In 2022, the Company recorded bonds at fair value in the amount of \$296,412,000, compared to bonds at fair value in the amount of \$295,443,000 during 2021. There were no restricted bonds and debentures at either December 31, 2022 or December 31, 2021.

A security has an impairment loss when its fair value is less than its cost or amortized cost at the reporting date. The Company evaluates its securities for other-than-temporary impairment losses at each quarter end. For each impaired security, the Company determines: 1) it does not intend to sell the security and 2) it is more likely than not that the Company will not be required to sell the security before recovery of its amortized cost basis. If the Company cannot assert these conditions, it records a permanent reduction of the security's cost equal to the impairment loss. The Company also assesses whether the net present value of cash flows expected to be collected from an impaired security are less than the security's amortized cost basis. If there is a shortfall in expected cash flows, the Company recognizes a permanent reduction of the security's cost basis equal to the shortfall. The Company recognized no other-than-temporary impairment losses in 2022 and 2021.

The Company reinsures excess losses on a portfolio of mortgage insurance policies that originated between 2009 and 2022. The Company provides collateral consisting of bonds of \$77,776,000 and \$59,556,000 at December 31, 2022 and December 31, 2021, respectively.

3. UNQUOTED INVESTMENTS - N/A

4. INVESTMENT IN AND ADVANCES IN AFFILIATES - N/A

5. INVESTMENT IN MORTGAGE LOANS ON REAL ESTATE

In January of 2021 the Company purchased the loan in settlement of a claim on two commercial real estate residual value insurance policies. In December 2021 one of the mortgage loans was paid off. The Company had investment in mortgage loans on real estate of \$1,033,000 and \$1,238,000 at December 31, 2022 and December 31, 2021, respectively.

6. POLICY LOANS - N/A

7. REAL ESTATE - N/A

8. COLLATERAL LOANS - N/A

9. INVESTMENT INCOME DUE AND ACCRUED

The Company had accrued investment income at December 31, 2022 and 2021 of \$1,696,000 and \$1,490,000, respectively.

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**10. ACCOUNTS AND PREMIUMS RECEIVABLE**

At December 31, 2022, the Company had amounts receivable of \$62,407,000, of which \$25,280,000 was due from affiliated companies, compared to amounts receivable at December 31, 2021 of \$62,196,000, of which \$33,979,000 was due from affiliated companies.

**11. REINSURANCE BALANCES RECEIVABLE - N/A**

**12. FUNDS HELD BY CEDING REINSURERS**

The Company has provided cash balances to affiliated ceding reinsurers as collateral against future losses incurred by the ceding reinsurers. Total funds held by ceding reinsurers at December 31, 2022 and 2021 were \$36,623,000 and \$27,243,000, respectively.

**13. SUNDRY ASSETS**

a. Derivative instruments

During 2004, the Company assumed a transaction whose underlying exposure is the value of a portfolio of home mortgages over a 22 year period as measured by the Halifax Price Index. The transaction went off risk in April 2022 resulting in a \$289,000 loss. The fair value of this contract was reported as a derivative asset of \$5,260,000 as of December 31, 2021.

b. Deferred commissions - Commission costs are deferred and charged to earnings proportionate with premiums earned.

c. Airplanes - During 2020, as a result of an RVI air claim, the Company took ownership of an Airbus A330 with a \$25,000,000 book value. Consistent with the reinsurance on the policy, the reinsurers had an interest of approximately 41% in the airplane. The ceded portion was reported as a sundry liability. In August 2022 the aircraft was sold for \$27,000,000, at which time the related sundry asset and sundry liability were removed. At December 31, 2021, the related sundry asset and liability were \$24,507,000 and \$10,070,000, respectively.

During 2021, as a result of an RVI air claim, the Company took ownership of a Boeing 777-300ER with a \$45,000,000 book value. The related sundry asset at December 31, 2022 and 2021 was \$43,281,000 and \$44,656,000, respectively.

During 2022, as a result of an RVI air claim, the Company took ownership of two airplanes:

Boeing 777-300ER with a \$33,500,000 book value. At December 31, 2022, the related sundry asset was \$33,122,000.

Boeing 777-300ER with a \$33,500,000 book value. At December 31, 2022, the related sundry asset was \$33,122,000.

d. Income tax receivable & deferred income taxes

The Company had a deferred tax asset of \$5,391,000 at December 31, 2022 and a current income tax receivable of \$6,667,000 at December 31, 2021.

**14. LETTERS OF CREDIT, GUARANTEES AND OTHER INSTRUMENTS**

In the event that the Company is unable to pay any policyholder obligations within 30 days after the obligation becomes due, the Company has obtained a guarantee from affiliated insurer, Houston Casualty Company, and an additional separate guarantee from affiliated insurer Tokio Marine & Nichido Fire Insurance Co., to pay or cause to be paid such obligations.

**16. UNEARNED PREMIUMS**

Premiums are written on an accrual basis, net of reinsurance, and are generally included in earnings on a pro-rata basis over the lives of the related policies and the unearned portion is recognized as a liability on the balance sheet and is computed by pro-rata method. Premiums for commercial title insurance policies are recognized in earnings on the effective date of the contract.

**17. LOSS AND LOSS EXPENSES PROVISIONS - See Part I, Note 4 (b)**

(a) Loss and loss expenses provisions table for the years ended December 31, 2022 and 2021:

	<u>2022</u>	<u>2021</u>
Gross loss and loss expense provisions at beginning of year	\$ 96,051,000	\$ 122,480,000
Less: Reinsurance recoverable at beginning of year	(22,384,000)	(1,145,000)
Net loss and loss expense provisions at beginning of year	73,667,000	121,335,000
Net Incurred Losses and Loss Expenses		
Current year	25,313,000	137,672,000
Prior years	(10,436,000)	(118,040,000)
Total net incurred losses and loss expenses	14,877,000	19,632,000
Net loss and loss expenses paid or payable related to:		
Current year	17,000	65,393,000
Prior years	(69,245,000)	11,000
Total losses and loss expense paid or payable	(69,228,000)	65,404,000
Foreign exchange and other	-	(1,896,000)
Net loss and loss expense provisions at end of year	157,772,000	73,667,000
Add: Reinsurance recoverable at end of year	6,280,000	22,384,000
Gross loss and loss expense provisions at end of year	\$ 164,052,000	\$ 96,051,000

(b) The Company had \$10,436,000 of favorable development in 2022 primarily related to release of IBNR on the RVI air line of business. Favorable loss development in 2021 of \$118,040,000 was due primarily to commutation of the Australian surety and stop-loss business.

During 2022, the Company increased its net loss provision for residual value insurance (RVI) business by \$83,894,000. During 2021, the Company released the \$109,738,000 loss provision related to the surety and stop-loss business and increased its loss provision for residual value insurance (RVI) business by \$61,829,000.

(c) Loss reserves related to RVI air claims are reported net of the associated salvage asset prior to the Company taking title to the insured asset. Once the Company takes title to the insured asset, the salvage asset is reclassified as a sundry asset and loss reserves no longer reflect the reduction for the associated asset. See Note 13c.

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- (d) At December 31, 2022 and 2021, the Company had unsecured policyholder obligations of \$164,052,000 and \$96,051,000, respectively. The Company did not have any restricted assets related to loss and loss expense provisions.

20. RESERVES FOR REPORTED CLAIMS - N/A

21. RESERVES FOR UNREPORTED CLAIMS - N/A

22. POLICY RESERVES - LIFE - N/A

23. POLICY RESERVES ACCIDENT AND HEALTH - N/A

24. POLICYHOLDERS' FUNDS ON DEPOSIT - N/A

25. LIABILITY FOR FUTURE POLICYHOLDERS' DIVIDENDS - N/A

26. OTHER INSURANCE RESERVES - LONG TERM - N/A

27. TOTAL LONG-TERM BUSINESS INSURANCE RESERVES - N/A

28. INSURANCE AND REINSURANCE BALANCES

The net amount payable by the Company for premiums and other balances under insurance or reinsurance contracts at December 31, 2022 and 2021 was \$11,314,000 and \$3,583,000, respectively.

29. COMMISSIONS, EXPENSES, FEES AND TAXES PAYABLE

At December 31, 2022, the Company had commission payable of \$12,571,000, of which, \$12,561,000 was due to an affiliated company.

30. LOANS AND NOTES PAYABLE - N/A

31. (a) INCOME TAXES PAYABLE

The Company is not subject to income tax in Bermuda. The Company has received an assurance from the Bermuda government to be exempted from all Bermuda taxes until March 31, 2035. However, the Company has elected to be treated as a U.S. domiciled company for U.S. income tax purposes. Therefore, income tax expense has been provided to record the Company's U.S. income taxes.

The Company and its U.S. subsidiaries are included in the consolidated Federal income tax return of HCC Insurance Holdings, Inc. and subsidiaries. The method of allocating taxes among the companies is subject to written agreement and approved by the Board of Directors. Under the terms of the agreement, income tax expense is allocated to companies with taxable income using a tax rate of 21%.

At December 31, 2022, the Company and subsidiaries had a current Federal income tax liability due to HCC Insurance Holdings, Inc. of \$666,000 in the consolidated balance sheet. At December 31, 2021, the Company and subsidiaries had a current Federal income tax receivable due from HCC Insurance Holdings, Inc. of \$6,667,000 in the consolidated balance sheet.

(b) DEFERRED INCOME TAXES

Deferred income tax is accounted for using the liability method, which reflects the tax impact of temporary differences between the bases of assets and liabilities for financial reporting purposes and such bases as measured by tax laws and regulations. The Company regularly reviews the deferred tax assets for recoverability and establishes a valuation allowance based on history of earnings, expectations for future earnings, taxable income in carryback years and the expected timing of the reversals of existing temporary differences. Due to the history of earnings, expectations for future earnings, and taxable income in carryback years, the Company expects to be able to fully realize the benefit of any net deferred tax asset, excluding amounts covered by valuation allowances, on a consolidated basis.

On December 31, 2022, the Company and subsidiaries had a net Federal deferred income tax asset of \$5,391,000 primarily due to unrealized losses on investments, unearned premium revenue and discounting of loss reserves offset by the timing of recognition of deferred policy acquisition costs and book over tax basis of the fixed assets. On December 31, 2021, the Company and subsidiaries had a net Federal deferred income tax liability of \$3,239,000 primarily due to the difference in the timing of recognition of deferred policy acquisition costs, unrealized gains on investments and financial instruments offset by unearned premium revenue, accrued interest and discounting of loss reserves.

At December 31, 2022 and December 31, 2021, there were no valuation allowances, net operating losses or tax liabilities for unrecognized gross tax benefits related to uncertain tax positions.

32. AMOUNTS DUE TO AFFILIATES

The Company is not subject to any repayment terms, rate of interest and/or collateral for payables to affiliates. The Company is part of a consolidated group and is subject to allocation of general expenses from HCC Service Company and other affiliates.

33. ACCOUNTS PAYABLE AND ACCRUED INVESTMENT EXPENSE

The Company had \$185,000 in accounts payable and accrued investment expense at December 31, 2022 and \$59,000 at December 31, 2021.

34. FUNDS HELD UNDER REINSURANCE CONTRACTS - N/A

35. DIVIDENDS PAYABLE - N/A

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PART VI

36. SUNDRY LIABILITIES

The Company had a hold back liability to cover any losses that may occur related to a previously purchased insurance company, Indemnity and Guaranty International Reinsurance Limited (IGIRL), of \$10,739,000 and \$9,421,000 at December 31, 2022 and 2021, respectively. Also, the Company had an earnout liability related to the IGIRL purchase of \$0 and \$710,000 at December 31, 2022 and 2021, respectively.

See Note 13 for details on the Reinsurers' Portion of Airplane.

In December 2022, the Company received a \$375,000 prepayment of the January 2023 airplane rent. The prepayment was recorded as other deferred revenue.

37. LETTERS OF CREDIT, GUARANTEES AND OTHER INSTRUMENTS - N/A

6. OTHER INSURANCE INCOME

The Company earned \$25,000 and \$0 of other insurance income during 2022 and 2021, respectively.

15. OTHER UNDERWRITING INCOME - N/A

32. COMBINED OTHER INCOME (DEDUCTIONS)

During 2022 and 2021, the Company recorded combined other income (deductions) consisting primarily of:

	<u>2022</u>	<u>2021</u>
Income from financing future premium on two RVI policies	\$ 168,000	\$ 7,079,000
Foreign currency gain/(loss)	(21,000)	1,040,000
Lease income from RVI airplane	2,823,000	377,000
Interest and fees received upon sale of RVI property	-	57,000
Earnout expense related to IGIRL purchase	(490,000)	(47,000)
<b>Total</b>	<b>\$ 2,480,000</b>	<b>\$ 8,506,000</b>

36. COMBINED REALIZED GAINS (LOSSES)

During 2022 and 2021, the Company recorded realized gains (losses) consisting of:

	<u>2022</u>	<u>2021</u>
Sale of bonds	\$ 24,000	\$ (159,000)
Change in fair value of derivatives	-	1,791,000
Sale of aircraft	1,297,000	-
Derivative going off risk	(289,000)	-
<b>Total</b>	<b>\$ 1,032,000</b>	<b>\$ 1,632,000</b>