Allied World Assurance Company, Ltd

Consolidated Financial Statements and Independent Auditors' Report for the Years Ended December 31, 2017, 2016, and 2015

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS
ALLIED WORLD ASSURANCE COMPANY, LTD

See accompanying notes to the consolidated financial statements.

Report of Independent Auditors

To the Board of Directors of
Allied World Assurance Company, Ltd

We have audited the accompanying consolidated financial statements of Allied World Assurance Company, Ltd and its subsidiaries (the "Company"), which comprise the consolidated balance sheet as of December 31, 2017, and the related consolidated statements of operations and comprehensive income, of shareholder's equity and of cash flows for the year then ended, including the related notes (collectively referred to as the "consolidated financial statements").

Management's Responsibility for the Consolidated Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on the consolidated financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

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

Opinion

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

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Other Matters

The consolidated financial statements of the Company as of December 31, 2016 and for the years ended December 31, 2016 and 2015 were audited by other auditors whose report, dated March 17, 2017, expressed an unmodified opinion on those statements.

Accounting principles generally accepted in the United States of America require that the information about incurred and paid loss developments for all periods preceding year ended December 31, 2017 and the related historical claims payout percentage disclosure for short-duration insurance contracts in Note 6 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by Financial Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

PricewaterhouseCoopers LLP

New York, New York
April 27, 2018

ALLIED WORLD ASSURANCE COMPANY, LTD
CONSOLIDATED BALANCE SHEETS
as of December 31, 2017 and 2016
(Expressed in thousands of United States dollars, except share and per share amounts)

	As of December 31, 2017	As of December 31, 2016
ASSETS:		
Fixed maturity investments trading, at fair value (amortized cost: 2017: $5,196,423; 2016: $6,403,496)	$ 5,192,591	$ 6,303,604
Equity securities trading, at fair value (cost: 2017: $824,804; 2016: $210,328)	826,632	219,231
Other invested assets	542,833	958,310
Total investments	6,562,056	7,481,145
Cash and cash equivalents	931,483	636,057
Restricted cash	97,153	66,043
Insurance balances receivable	742,161	693,847
Funds held	427,142	461,843
Prepaid reinsurance	490,623	453,400
Reinsurance recoverable	2,050,941	1,550,459
Reinsurance recoverable on paid losses	169,192	99,001
Accrued investment income	11,131	33,779
Net deferred acquisition costs	105,632	109,489
Goodwill	389,956	389,693
Intangible assets	98,720	104,745
Balances receivable on sale of investments	194,654	48,337
Net deferred tax assets	36,475	42,948
Loans to affiliates	—	40,173
Amounts due from affiliates	203,820	91,798
Other assets	136,090	109,391
Total assets	$ 12,647,229	$ 12,412,149
LIABILITIES:		
Reserve for losses and loss expenses	$ 7,170,469	$ 6,255,627
Unearned premiums	1,588,547	1,549,440
Reinsurance balances payable	263,974	208,060
Long-term debt	22,500	—
Balances due on purchases of investments	7,264	79,647
Dividends payable	60,550	102,675
Amounts due to affiliates	111,896	28,287
Accounts payable and accrued liabilities	147,146	153,353
Total liabilities	$ 9,372,346	$ 8,377,089
SHAREHOLDER'S EQUITY:		
Common shares, par value $1 per share, issued and outstanding 2017: 1,000,000 shares and 2016: 1,000,000 shares	$ 1,000	$ 1,000
Additional paid-in capital	2,276,133	2,292,137
Accumulated other comprehensive loss	(1,636)	(11,557)
Retained earnings	993,774	1,753,480
Total shareholder's equity	$ 3,269,271	$ 4,035,060
Shareholder's equity non-VIE non-controlling interests	5,987	—
Shareholder's equity VIE non-controlling interests	(375)	—
Total shareholder’s equity available to Allied World Assurance Company, Ltd.	$ 3,274,883	$ 4,035,060
Total liabilities and shareholder's equity	$ 12,647,229	$ 12,412,149

See accompanying notes to the consolidated financial statements.

ALLIED WORLD ASSURANCE COMPANY, LTD
CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME
for the years ended December 31, 2017, 2016 and 2015
(Expressed in thousands of United States dollars)

	2017	2016	2015
REVENUES:			
Gross premiums written	$ 2,812,361	$ 2,813,952	$ 2,797,046
Premiums ceded	(791,297)	(756,574)	(597,220)
Net premiums written	2,021,064	2,057,378	2,199,826
Change in unearned premiums	(2,287)	69,156	101,906
Net premiums earned	2,018,777	2,126,534	2,301,732
Net investment income	166,222	201,062	175,293
Net realized investment gains (losses)	5,797	(19,571)	(121,328)
Other income	15,130	14,385	5,991
	2,205,926	2,322,410	2,361,688
EXPENSES:			
Net losses and loss expenses	1,830,938	1,339,812	1,459,402
Acquisition costs	282,082	310,794	365,053
General and administrative expenses	295,170	351,327	321,205
Other expenses	56,448	6,792	6,207
Amortization and impairment of intangible assets	9,280	10,724	9,759
Foreign exchange losses (gains)	3,423	(4,501)	4,774
	2,477,341	2,014,948	2,166,400
Income before income taxes	(271,415)	307,462	195,288
Income tax (benefit) expense	(6,821)	(11,919)	2,361
NET (LOSS) INCOME INCLUDING NON-CONTROLLING INTERESTS	(264,594)	319,381	192,927
Net (loss) income non-controlling non-VIE interests	(1,513)	—	—
Net (loss) income non-controlling VIE interests	(375)	—	—
NET (LOSS) INCOME AFTER DEDUCTING NON-CONTROLLING INTERESTS	(262,706)	319,381	192,927
Other comprehensive (loss) gain: Foreign currency translation adjustment	9,920	(2,260)	(9,297)
COMPREHENSIVE (LOSS) INCOME INCLUDING NON-CONTROLLING INTERESTS	(252,785)	317,121	183,630
Comprehensive (loss) income non-controlling non-VIE interests	(1,513)	—	—
Comprehensive (loss) income non-controlling VIE interests	(375)	—	—
COMPREHENSIVE (LOSS) INCOME AFTER DEDUCTING NON-CONTROLLING INTERESTS	$ (250,897)	$ 317,121	$ 183,630

See accompanying notes to the consolidated financial statements.

ALLIED WORLD ASSURANCE COMPANY, LTD
CONSOLIDATED STATEMENTS OF SHAREHOLDER'S EQUITY
for the years ended December 31, 2017, 2016 and 2015
(Expressed in thousands of United States dollars)

	Share Capital	Additional Paid-in Capital	Accumulated Other Comprehensive Loss	Retained Earnings	Non-controlling interest	Total
January 1, 2015	$ 1,000	$ 2,021,848	$ —	$ 2,196,172	$ —	$ 4219,020
Net income	—	—	—	192,927	—	192,927
Dividends	—	—	—	(476,000)	—	(476,000)
Other comprehensive loss	—	—	(9,297)	—	—	(9,297)
Capital contribution	—	497,000	—	—	—	497,000
Stock compensation	—	9,269	—	—	—	9,269
Employee share purchases	—	870	—	—	—	870
December 31, 2015	$ 1,000	$ 2,528,987	$ (9,297)	$ 1,913,099	$ —	$ 4,433,789
January 1, 2016	$ 1,000	$ 2,528,987	$ (9,297)	$ 1,913,099	$ —	$ 4,433,789
Net income	—	—	—	319,381	—	319,381
Dividends	—	—	—	(479,000)	—	(479,000)
Other comprehensive loss	—	—	(2,260)	—	—	(2,260)
Return of capital	—	(250,000)	—	—	—	(250,000)
Stock compensation	—	12,242	—	—	—	12,242
Employee share purchases	—	908	—	—	—	908
December 31, 2016	$ 1,000	$ 2,292,137	$ (11,557)	$ 1,753,480	$ —	$ 4,035,060
January 1, 2017	$ 1,000	$ 2,292,137	$ (11,557)	$ 1,753,480	$ —	$ 4,035,060
Net loss	—	—	—	(264,594)	—	(264,594)
Dividends	—	—	—	(497,000)	—	(497,000)
Other comprehensive loss	—	—	9,921	—	—	9,921
Non-controlling interest equity	—	(7,500)	—	1,888	5,612	—
Fairfax contribution	—	47,618	—	—	—	47,618
Stock compensation	—	(56,407)	—	—	—	(56,407)
Employee share purchases	—	285	—	—	—	285
December 31, 2017	$ 1,000	$ 2,276,133	$ (1,636)	$ 993,774	$ 5,612	$ 3,274,883

See accompanying notes to the consolidated financial statements.

ALLIED WORLD ASSURANCE COMPANY, LTD
CONSOLIDATED STATEMENTS OF CASH FLOWS
for the years ended December 31, 2017, 2016 and 2015
(Expressed in thousands of United States dollars)

	2017	2016	2015
CASH FLOWS PROVIDED BY OPERATING ACTIVITIES:			
Net (loss) income	$ (264,594)	$ 319,381	$ 192,927
Adjustments to reconcile net income to cash provided by operating activities:			
Net realized (losses) gains on sales of investments	(32,719)	(19,380)	(73,515)
Mark-to-market adjustments	22,380	15,708	183,078
Stock compensation expense	17,646	14,167	13,670
Undistributed income of equity method investments	136	4,895	15,364
Changes in:			
Reserve for losses and loss expenses, net of reinsurance recoverable	414,360	(50,176)	93,524
Unearned premiums, net of prepaid reinsurance	1,883	(70,109)	(105,418)
Insurance balances receivable	(48,314)	(23,232)	37,015
Reinsurance recoverable on paid losses	(70,191)	(5,026)	(9,336)
Funds held	34,701	175,313	85,033
Reinsurance balances payable	55,914	2,425	(5,198)
Net deferred acquisition costs	3,857	35,743	29,990
Net deferred tax assets	6,472	(16,671)	(4,154)
Accounts payable and accrued liabilities	(6,208)	12,035	2,553
Change in amounts due from affiliates	83,610	3,506	(51,910)
Change in amounts due to affiliates	(112,022)	1,323	(9,701)
Other items, net	(13,719)	9,956	135,534
Net cash provided by operating activities	93,192	409,858	529,456
CASH FLOWS PROVIDED BY (USED IN) INVESTING ACTIVITIES:			
Purchases of trading securities	(7,429,089)	(5,187,222)	(5,649,132)
Purchases of other invested assets	(193,836)	(118,973)	(126,661)
Sales of trading securities	7,966,626	5,770,532	5,244,524
Sales of other invested assets	377,642	101,511	161,308
Purchases of fixed assets	(8,793)	(2,966)	(23,025)
Change in restricted cash	(31,111)	(13,496)	19,631
Loans to affiliates	40,173	11,955	13,505
Net cash paid for acquisitions	—	—	(124,420)
Net cash provided by (used in) investing activities	721,612	561,341	(484,270)
CASH FLOWS (USED IN) PROVIDED BY FINANCING ACTIVITIES:			
Dividends paid	(539,125)	(584,375)	(432,700)
Proceeds from capital contribution	—	—	497,000
Return of capital	—	(250,000)	—
Proceeds from other long-term debt	22,500	—	—
Fairfax contribution	47,619	—	—
Vault capital contribution received	7,500	—	—
Purchase of restricted shares	(60,664)	—	—
Net cash (used in) provided by financing activities	(522,170)	(834,375)	64,300
Effect of exchange rate changes on foreign currency cash	2,791	(400)	(4,417)
NET INCREASE IN CASH AND CASH EQUIVALENTS	295,425	136,424	105,069
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	636,057	499,633	394,564
CASH AND CASH EQUIVALENTS, END OF YEAR	$ 931,483	$ 636,057	$ 499,633
Supplemental disclosure of cash flow information:			
— Cash paid for income taxes	$ 2,925	$ 3,385	$ 1,996

See accompanying notes to the consolidated financial statements.

ALLIED WORLD ASSURANCE COMPANY, LTD
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Expressed in thousands of United States dollars, except share amounts)

1. GENERAL

Allied World Assurance Company, Ltd ("Allied World") was incorporated in Bermuda on November 13, 2001 and is a wholly owned subsidiary of Allied World Assurance Company Holdings, Ltd ("Allied World Bermuda"). Allied World Bermuda is wholly owned subsidiary of Allied World Assurance Company Holdings, GmbH ("Allied World Switzerland").

Allied World, through its branches and wholly-owned subsidiaries (collectively the "Company"), provides property and casualty insurance and reinsurance on a worldwide basis. References to "$" are to the lawful currency of the United States and to "CHF" are to the lawful currency of Switzerland.

The Company's Insurance operations include direct insurance operations in the United States, Bermuda, Canada, Europe and Asia Pacific. The Reinsurance operations include the United States, Bermuda, Europe and Singapore.

On July 6, 2017, Fairfax Financial Holdings Limited ("Fairfax"), through Fairfax Financial Holdings (Switzerland) GmbH ("Fairfax Switzerland"), completed the acquisition of 94.6% of the outstanding shares of Allied World Assurance Company Holdings, AG ("Allied World AG") for purchase consideration of $3,977,900, consisting of $1,905,600 in cash and $2,072,300 by the issuance of 4,799,497 subordinate voting shares of Fairfax. In addition, Allied World AG declared a special pre-closing cash dividend of $5.00 per share ($438,000). Contemporaneously with the closing of the acquisition of Allied World AG, Ontario Municipal Employees Retirement System ("OMERS"), the pension plan manager for government employees in the province of Ontario, Alberta Investment Management Corporation ("AIMCo"), an investment manager for pension, endowment and government funds in the province of Alberta, and certain other third parties (together "the co-investors") invested $1,580,000 for an indirect equity interest in Allied World AG. The remaining 5.4% of the outstanding shares of Allied World AG was acquired by Fairfax Switzerland on August 17, 2017 for purchase consideration of $229,000, consisting of $109,700 in cash and $119,300 by the issuance of 276,397 subordinate voting shares of Fairfax, in a merger transaction under Swiss law pursuant to which Allied World Switzerland became the surviving entity. This merger resulted in the co-investors holding an indirect ownership interest in Allied World Switzerland of 32.6%. The co-investors will have a dividend in priority to Fairfax, and Fairfax will have the ability to purchase the shares owned by the co-investors over the next seven years.

2. SIGNIFICANT ACCOUNTING POLICIES

These consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("U.S. GAAP"). The preparation of financial statements in conformity with U.S. 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. Actual results could differ from those estimates. The significant estimates reflected in the Company's financial statements include, but are not limited to:

- The premium estimates for certain reinsurance agreements,
- Recoverability of deferred acquisition costs,
- The reserve for outstanding losses and loss expenses,
- Valuation of ceded reinsurance recoverables,
- Determination of impairment of goodwill and other intangible assets, and
- Valuation of financial instruments.

Intercompany accounts and transactions have been eliminated on consolidation and all entities meeting consolidation requirements have been included in the consolidated financial statements. To facilitate comparison of information across periods, certain reclassifications have been made to prior year amounts to conform to the current year's presentation.

The significant accounting policies are as follows:

a) Premiums and Acquisition Costs

Premiums are recorded as written on the inception date of the policy. For certain types of business written by the Company, notably assumed reinsurance, the exact premium income may not be known at the policy inception date. In the case of quota share reinsurance treaties assumed by the Company, the underwriter makes an estimate of premium income at inception. The underwriter's estimate is based on statistical data provided by reinsureds and the underwriter's judgment and experience. Such estimations are refined over the reporting period of each treaty as actual written premium information is reported by ceding companies and intermediaries. Premiums resulting from changes in the estimate of the premium income are recorded in the period the estimate is changed. Certain insurance and reinsurance contracts may require that the premium be adjusted at the expiry of the contract to reflect the change in exposure or loss experience of the insured or reinsured.

Premiums are recognized as earned over the period of policy coverage in proportion to the risks to which they relate. Reinsurance premiums under a losses-occurring reinsurance contract are earned over the coverage period. Reinsurance premiums under a risks-attaching reinsurance contract are earned over the same period as the underlying policies, or risks, covered by the contract. As a result, the earning pattern of a risks-attaching reinsurance contract may extend up to 24 months, reflecting the inception dates of the underlying policies. Premiums relating to the unexpired periods of coverage are recorded on the consolidated balance sheets as "unearned premiums".

Acquisition costs, comprised of commissions, brokerage fees and insurance taxes, are costs that are directly related to the successful acquisition of new and renewal business and are deferred. Although permitted under U.S. GAAP to defer certain internal costs that are directly related to the successful acquisition of new and renewal business, the Company does not defer such costs. Acquisition costs that are deferred, and carried on the balance sheet as an asset, are expensed as the premiums to which they relate are earned. Expected losses and loss expenses, other costs and anticipated investment income related to these unearned premiums are considered in determining the recoverability or deficiency of deferred acquisition costs. If it is determined that deferred acquisition costs are not recoverable, they are expensed. Further analysis is performed to determine if a liability is required to provide for losses which may exceed the related unearned premiums.

Acquisition costs recorded in the consolidated statements of operations and comprehensive income ("consolidated income statements") includes other acquisition-related costs such as profit commissions that are expensed as incurred and the amortization of insurance-related intangible assets.

b) Reserve for Losses and Loss Expenses

The reserve for losses and loss expenses is comprised of two main elements: outstanding loss reserves ("OSLR," also known as case reserves) and reserves for losses incurred but not reported ("IBNR"). OSLR relate to known claims and represent management's best estimate of the likely loss payment. Reserves for IBNR relates to reserves established by the Company for claims that have occurred but have not yet been reported to us as well as for changes in the values of claims that have been reported to us but are not yet settled. See Note 6 for additional information.

c) Ceded Reinsurance

In the ordinary course of business, the Company uses both treaty and facultative reinsurance to minimize its net loss exposure to any one catastrophic loss event or to an accumulation of losses from a number of smaller events. Reinsurance premiums ceded are expensed and any commissions recorded thereon are earned over the period the reinsurance coverage is provided in proportion to the risks to which they relate. For reinsurance treaties that have contractual minimum premium provisions, premiums ceded are recorded at the inception of the treaty based on the minimum premiums. Prepaid reinsurance represents unearned premiums ceded to reinsurance companies. Any unearned ceding commission is included in "net deferred acquisitions costs" on the consolidated balance sheets and is recorded as a reduction to the overall net deferred acquisition cost balance.

Reinsurance recoverable includes the balances due from those reinsurance companies under the terms of the Company's reinsurance agreements for unpaid losses and loss reserves, including IBNR, and is presented net of a provision for uncollectible reinsurance. Amounts recoverable from reinsurers are estimated in a manner consistent with the estimated claim liability associated with the reinsured policy. The Company determines the portion of the IBNR liability that will be recoverable under its reinsurance contracts by reference to the terms of the reinsurance protection purchased. This determination is necessarily based on the estimate of IBNR and accordingly, is subject to the same uncertainties as the estimate of IBNR.

The Company remains liable to the extent that its reinsurers do not meet their obligations under the reinsurance contracts; therefore, the Company regularly evaluates the financial condition of its reinsurers and monitors concentration of credit risk.

d) Investments

All fixed maturity investments and equity securities are classified as trading securities as the Company has elected the fair value option permitted under U.S. GAAP for these investments at the time each security was acquired. Trading securities are carried at fair value with any change in unrealized gains or losses recognized in the consolidated income statements and included in "net realized investment gains (losses)". As a result of this investment classification, the Company does not record any change in unrealized gains or losses on investments as a separate component of accumulated other comprehensive income on the consolidated balance sheets.

Other invested assets consist primarily of investments in hedge funds and private equity funds, which have been accounted for as trading securities as the Company has elected the fair value option as permitted under U.S. GAAP at the time each investment was acquired. In addition, included in the Company's other invested assets are various investments which are accounted for using the equity method of accounting. Generally, the Company uses the equity method where it does not have a controlling interest and is not the primary beneficiary. Equity method investments are recorded at cost and adjusted for the Company's proportionate share of earnings or losses on a quarterly lag basis. An other-than-temporary impairment charge related to the equity method investments is assessed when facts and circumstances exists that indicate an impairment may exist. An other-than-temporary impairment charge is recorded when it is determined that the carrying value of the equity method investment is below its fair value and the Company does not have the intent and ability to hold to recovery. See note 3(c) for additional information regarding an other-than-temporary impairment charge recorded in 2017 related to one of the Company's equity method investments. Other investments are recorded based on valuation techniques depending on the nature of the individual assets.

At each measurement date, the Company estimates the fair value of the financial instruments using various valuation techniques. The Company utilizes, to the extent available, quoted market prices in active markets or observable market inputs in estimating the fair value of financial instruments. When quoted market prices or observable market inputs are not available, the Company may utilize valuation techniques that rely on unobservable inputs to estimate the fair value of financial instruments, which principally relates to non-binding broker-dealer quotes. The Company bases its determination of whether a market is active or inactive on the spread between what a seller is asking for a security and what a buyer is bidding for that security. Spreads that are significantly above historical spreads are considered inactive markets. The Company also considers the volume of trading activity in the determination of whether a market is active or inactive. See Note 5 for additional information regarding the fair value of financial instruments.

The Company utilizes independent pricing sources to obtain market quotations for securities that have quoted prices in active markets. In general, the independent pricing sources use observable market inputs including, but not limited to, investment yields, credit risks and spreads, benchmarking of like securities, reported trades and sector groupings to determine the fair value. For a majority of the portfolio, the Company obtained two or more prices per security as of December 31, 2017. When multiple prices are obtained, a price source hierarchy is utilized to determine which price source is the best estimate of the fair value of the security. The price source hierarchy emphasizes more weighting to significant observable inputs such as index pricing and less weighting towards non-binding broker-dealer quotes. The Company will investigate any material differences, if any, between the multiple sources and determines which price best reflects the fair value of the individual security. There were no material differences between the prices obtained from the independent pricing sources and the prices obtained from the Company's investment portfolio managers and other sources as of December 31, 2017 and 2016.

Investment securities are recorded on a trade date basis. Investment income is recognized when earned and includes the accrual of discount or amortization of premium on fixed maturity investments using the effective yield method and is net of related expenses. Interest income for fixed maturity investments is accrued and recognized based on the contractual terms of the fixed maturity investments and is included in "net investment income" in the consolidated income statements. For mortgage-backed and asset-backed securities and any other holdings for which there is a prepayment risk, prepayment assumptions are evaluated and revised on a regular basis. Revised prepayment assumptions are applied to securities on a retrospective basis to the date of acquisition. The cumulative adjustments to amortized cost required due to these changes in effective yields and maturities are recognized in net investment income in the same period as the revision of the assumptions. The Company's share of undistributed net income from equity method investments is included in net investment income. The return on investments is managed on a total financial statement portfolio return basis, which includes the undistributed net income from equity method investments, and as such have classified these amounts in net investment income.

Realized gains and losses on the disposition of investments, which are based upon the first-in first-out method of identification, are included in "net realized investment gains (losses)" in the consolidated income statements.

e) Consolidation

Subsidiaries - The Company's consolidated financial statements include the assets, liabilities, equity, revenue, expenses and cash flows of the Company and its subsidiaries. A subsidiary is an entity over which the Company has control. The Company controls an entity when the Company has power over the entity, is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. Assessment of control is based on the substance of the relationship between the Company and the entity and includes consideration of both existing voting rights and, if applicable, potential voting rights that are currently exercisable and convertible. The operating results of subsidiaries acquired are included in the consolidated financial statements from the date control is acquired (typically the acquisition date). The operating results of subsidiaries that are divested during the year are included up to the date control ceased (typically the disposition date) and any difference between the fair value of the consideration received and the carrying value of a divested subsidiary is recognized in the consolidated income statements. Accounting policies of subsidiaries have been aligned with those of the Company where necessary.

The Company is involved in the normal course of business with variable interest entities (“VIEs”) as a passive investor in certain asset-backed securities issued by third party VIEs and affiliated VIEs, as well as certain of its hedge fund and private equity fund investments. The Company performs a qualitative assessment at the date when it becomes initially involved in the VIE, followed by ongoing reassessments related to its involvement in VIEs. The Company's maximum exposure to loss with respect to these investments is limited to the investment carrying amounts reported in the Company’s consolidated balance sheets and any unfunded commitments.

Under U.S. GAAP, certain limited partnership investments and similar legal entity investments are considered VIEs because there are no substantive kick-out or other participating rights. These VIEs have not been consolidated because the Company has determined it is not considered the primary beneficiary, as it does not have both the power to direct the activities that most significantly impact the economic performance of the entity and the obligation to absorb losses of the entity that could be potentially significant to the VIE or the right to receive benefits from the entity that could be potentially significant. As such, the Company continues to record its interests in these entities at fair value, with changes in fair value recorded in the consolidated income statements. The Company's interests in these entities are recorded in “other invested assets” in the consolidated balance sheets. The Company's maximum exposure to loss in these entities, which is the sum of the carrying value and the unfunded commitment, was $524,600 as of December 31, 2017.

The Company also has a variable interest in a reciprocal insurance entity that was created during 2017 and of which it is the primary beneficiary. The net liabilities of the reciprocal insurance entity as of December 31, 2017 was $800 and the net loss for the period from inception to December 31, 2017 was $800.

f) Translation of Foreign Currencies

Functional and presentation currency - The consolidated financial statements are presented in U.S. dollars which is the Company's functional and presentation currency.

Foreign currency transactions - Foreign currency transactions are translated into the functional currencies of the Company's subsidiaries using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognized in the consolidated income statements. Non-monetary items carried at cost are translated using the exchange rate at the date of the transaction. Non-monetary items carried at fair value are translated at the date the fair value is determined.

Translation of foreign subsidiaries - The functional currencies of some of the Company's subsidiaries differ from the consolidated group U.S. dollar presentation currency. As a result, the assets and liabilities of these foreign subsidiaries (including goodwill and fair value adjustments arising on their acquisition, where applicable) are translated on consolidation at the rates of exchange prevailing at the balance sheet date. Revenue and expenses are translated at the average rate of exchange for the period. The net unrealized gain or loss resulting from this translation is recognized in accumulated other comprehensive income, and only recycled to the consolidated income statements upon reduction of an investment in a foreign subsidiary.

g) Cash and Cash Equivalents and Restricted Cash

Cash and cash equivalents include amounts held in banks, time deposits, commercial paper, discount notes and U.S. Treasury Bills with maturities of less than three months from the date of purchase. Restricted cash primarily relates to cash held in trust accounts in favor of cedents, other counterparties or government authorities, as well as accounts that are pledged as collateral for the Company's letter of credit facilities.

h) Income Taxes

Certain of the Company's subsidiaries operate in jurisdictions where they are subject to income taxation. Current and deferred income taxes are charged or credited to operations, or to shareholders' equity in certain cases, based upon enacted tax laws and rates applicable in the relevant jurisdiction in the period in which the tax becomes payable. Deferred income taxes are provided for all temporary differences between the bases of assets and liabilities used in the financial statements and those used in the various jurisdictional tax returns.

It is the Company's policy to recognize interest accrued related to unrecognized tax benefits in "interest expense" and penalties in "general and administrative expenses" in the consolidated income statements. The Company has not recorded any interest or penalties during the years ended December 31, 2017, 2016 and 2015 and the Company has not accrued any payment of interest and penalties as of December 31, 2017 and 2016.

i) Restricted Stock Units

The Company had granted restricted stock units ("RSUs") to certain employees. The compensation expense for the RSUs was based on the market value of Allied World Switzerland's common shares on the grant date, and was recognized on a straight-line basis over the applicable vesting period.

The Company had also granted cash-equivalent RSUs to certain employees that vested on a straight-line basis over the applicable vesting period. The amount payable per unit awarded was equal to the price per share of Allied World Switzerland's common shares and as such the Company measured the value of the award each reporting period based on the period ending share price. The effects of changes in the share price at each period end during the service period were recognized as increases or decreases in compensation expense over the service period. As a result of the acquisition of the Company by Fairfax, all unvested RSU's had their vesting accelerated and were settled in cash.

The Company now participates in the Fairfax Financial Restricted Share Plan. The Fairfax Plans generally provide officers, key employees and directors who were employed by or provided services to the Company with awards of restricted shares of Fairfax common stock. The restricted share awards generally vest over five years.

j) Performance-Based Equity Awards

The Company had granted performance-based equity awards to key employees in order to promote the long-term growth and profitability of the Company. Each award represented the right to receive a number of common shares in the future, based upon the achievement of established performance criteria during the applicable performance period. These performance-based equity awards vested after a three-year performance period. The compensation expense for these awards was based on the market value of Allied World Switzerland's common shares on the grant date, and was recognized on a straight-line basis over the applicable performance and vesting period. The Company adjusted the compensation expense, as a cumulative adjustment, to the extent the Company's performance was above or below the targeted performance criteria.

The Company had also granted cash-equivalent, performance-based awards to certain employees that vested based upon the achievement of established performance criteria during the applicable performance period. These cash-equivalent, performance-based awards vested after a three-year performance period. The amount payable per unit awarded was be equal to the price per share of Allied World Switzerland's common shares, and as such the Company measured the value of the award each reporting period based on the period-ending share price. The effects of changes in the share price at each period end during the service period were recognized as changes in compensation expense over the service period. The Company also adjusted the compensation expense, as a cumulative adjustment, to the extent the Company's performance was above or below the targeted performance criteria. As a result of the acquisition of the Company by Fairfax, all unvested performance-based equity awards had their vesting accelerated and were settled in cash.

k) Goodwill and Intangible Assets

The Company classifies its intangible assets into three categories: (1) intangible assets with finite lives subject to amortization, (2) intangible assets with indefinite lives not subject to amortization, and (3) goodwill. Intangible assets, other than goodwill, generally consist of customer renewal rights, distribution channels, internally generated software, non-compete covenants, trademarks, and insurance licenses.

For intangible assets with finite lives, the value of the assets is amortized over their expected useful lives and the expense is included in "amortization and impairment of intangible assets" in the consolidated income statements. The Company tests assets for impairment if conditions exist that indicate the carrying value may not be recoverable. If, as a result of the evaluation, the Company determines that the value of the intangible assets is impaired, then the value of the assets will be written-down in the period in which the determination of the impairment is made.

For indefinite lived intangible assets the Company does not amortize the intangible asset but evaluates and compares the fair value of the assets to their carrying values on an annual basis or more frequently if circumstances warrant. If, as a result of the evaluation, the Company determines that the value of the intangible assets is impaired, then the value of the assets will be written-down in the period in which the determination of the impairment is made.

Goodwill represents the excess of the cost of acquisitions over the fair value of net assets acquired and is not amortized. Goodwill is assigned at acquisition to the applicable reporting unit(s) based on the expected benefit to be received by the reporting units from the business combination. The Company determines the expected benefit based on several factors including the purpose of the business combination, the strategy of the Company subsequent to the business combination and structure of the acquired company subsequent to the business combination. A reporting unit is a component of the Company's business that has discrete financial information that is reviewed by management. In determining the reporting unit, the Company analyzes the inputs, processes, outputs and overall operating performance of the reporting unit. The Company has several reporting units to which the goodwill is allocated to.

For goodwill, the Company performs an annual impairment test, or more frequently if circumstances are warranted. The Company may first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. The results of the qualitative assessment will determine if an entity needs to proceed with the two-step goodwill impairment test. For the year ended December 31, 2017, the Company elected to bypass the qualitative assessment and performed the first step of the goodwill impairment test.

The first step of the goodwill impairment test is to compare the fair value of the reporting unit with its carrying value, including goodwill. If the carrying amount of the reporting unit exceeds its fair value then the second step of the goodwill impairment test is performed.

The second step of the goodwill impairment test determines the goodwill impairment as the difference between the carrying value of reporting unit and its fair value as calculated in the first step of the goodwill impairment test.

We recorded no goodwill impairments during the years ended December 31, 2017, 2016 and 2015.

l) Derivative Instruments

The Company utilizes derivative financial instruments as part of its overall risk management strategy. The Company recognizes all derivative financial instruments at fair value as either assets or liabilities on the consolidated balance sheets. The accounting for gains and losses associated with changes in the fair value of a derivative and the effect on the consolidated financial statements depends on its hedge designation and whether the hedge is highly effective in achieving offsetting changes in the fair value of the asset or liability hedged.

The Company uses currency forward contracts and foreign currency swaps to manage currency exposure. The Company also utilizes various derivative instruments such as interest rate futures, interest rate swaps and index options, for the purpose of managing market exposures, interest rate volatility, portfolio duration, hedging certain investments, or enhancing investment performance. These derivatives are not designated as hedges and accordingly are carried at fair value on the consolidated balance sheets with realized and unrealized gains and losses included in the consolidated income statements. Refer to Note 4 for the Company's related disclosure.

In addition, the Company's derivative instruments include insurance or reinsurance contracts that are required to be accounted for as derivatives. This will be the case when the insurance or reinsurance contract provides indemnification to the insured or cedent as a result of a change in a variable versus an identifiable insurable event. The Company considers these insurance and reinsurance contracts to be an extension of its overall insurance operations. The insurance and reinsurance derivative contracts are recorded at fair value, with net premiums received recognized in "Net premiums earned" over the period of policy coverage in proportion to the risk to which it relates, and other changes in the fair value of this contract is recorded in "other income" or "other expense" in the consolidated income statements. To the extent losses are incurred or ceded under these contracts, those net losses would be recorded in "net losses and loss expenses". During the year ended December 31, 2017, the Company recorded net premiums earned of $1,500, other income of $11,200, and other expense of $4,400 related to these insurance and reinsurance derivative contracts. During the year ended December 31, 2016, the Company recorded net premiums earned of $100, other income of $7,700, and other expense of $3,400 related to these insurance and reinsurance derivative contracts.

m) Treasury Shares

As part of the Fairfax Financial Restricted Share Plan, the Company purchases, from time to time, Fairfax shares for issuances to employees. The Fairfax shares are recorded in “additional paid-in capital” in the consolidated balance sheet and based on the fair value at the time of purchase. Prior to being acquired by Fairfax, common shares repurchased by the Company and not subsequently canceled are classified as “treasury shares” on the consolidated balance sheets and are recorded at cost. When shares were reissued from treasury, the historical cost, based on the first-in, first-out method, was used to determine the cost of the reissued shares. The difference between the cost of the treasury shares and the par value of the common stock shall be first reflected as additional paid-in capital, but to the extent additional paid-in capital is exhausted the remainder shall reduce retained earnings. The issuance of shares out of treasury have been related to vesting equity-based compensation of the Company's employees and directors.

n) New Accounting Pronouncements

In February 2016, the Financial Accounting Standards Board (the “FASB”) issued Accounting Standards Update 2016-02, “Leases” (“ASU 2016-02”). ASU 2016-02 changes current U.S. GAAP for lessees to recognize lease assets and lease liabilities on the balance sheet for those leases classified as operating leases under previous U.S. GAAP. ASU 2016-02 is effective for annual periods beginning after January 1, 2019, including interim periods. Early application is permitted. The Company is currently assessing the impact that the adoption of ASU 2016-02 will have on future financial statements and disclosures. Specifically, the Company is still evaluating its existing leases to determine the appropriate classification under the new standard and whether it will adopt the practical expedients allowed under ASU 2016-02. The Company will adopt the amendments in ASU 2016-02 for reporting periods beginning January 1, 2020, as ASU 2017-13 allows for delayed adoption for entities that meet certain criteria. A summary of ASU 2017-13 is provided later in this note.

In June 2016, the FASB issued Accounting Standards Update 2016-13, “Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments” (“ASU 2016-13”). ASU 2016-13 modifies U.S. GAAP related to the recognition of credit losses by replacing the incurred loss impairment methodology in current U.S. GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. ASU 2016-13 would apply to financial assets such as loans, debt securities, trade receivables, off-balance sheet credit exposures, reinsurance receivables, and other financial assets that have the contractual right to receive cash. The measurement of expected credit losses is based on relevant information about past events, including historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the reported amount. The Company's invested assets are measured at fair value through net income, and therefore those invested assets would not be impacted by the adoption of ASU 2016-13. The Company has other financial assets, such as reinsurance recoverables, that could be impacted by the adoption of ASU 2016-13. ASU 2016-13 is effective for annual periods beginning after January 1, 2020, including interim periods. The Company is currently assessing the impact that the adoption of ASU 2016-13 will have on future financial statements and disclosures. Specifically, the Company is developing a credit impairment methodology for its reinsurance recoverables based on the guidance in ASU 2016-13.

In August 2016, the FASB issued Accounting Standards Update 2016-15, “Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments” (“ASU 2016-15”). ASU 2016-15 clarifies the classification of receipts and payments in the statement of cash flows. ASU 2016-15 provides guidance related to (1) settlement and payment of zero coupon debt instruments, (2) contingent consideration, (3) proceeds from settlement of insurance claims, (4) proceeds from settlement of corporate and bank-owned life insurance policies, (5) distributions from equity method investees, (6) cash receipts from beneficial interests obtained by a transferor, and (7) general guidelines for cash receipts and payments that have more than one aspect of classification. The only item above that will impact the Company is the guidance related to distributions from equity method investees. The Company currently utilizes the nature of distribution approach for classifying such distributions and will adopt ASU 2016-15 for reporting periods beginning January 1, 2019, which is the timeline for nonpublic entities. As the nature of distribution approach is an acceptable method under ASU 2016-15, the Company does not expect the adoption of ASU 2016-15 to have a material impact on its statement of cash flows.

In May 2017, the FASB issued Accounting Standards Update 2017-09 “Compensation - Stock Compensation (Topic 718): Scope of Modification Accounting” (“ASU 2017-09”). ASU 2017-09 requires that entities account for the effects of a change in terms or conditions of a share based award unless all of the following conditions are met: (1) the fair value of the modified award is the same as the fair value of the original award immediately before the original award is modified, (2) the vesting conditions of the modified award are the same as the vesting conditions immediately before the award was modified, and (3) the classification of the modified award as an equity or liability instrument is the same as the classification of the original award immediately before it was modified. ASU 2017-09 is effective for fiscal years beginning after December 15, 2017. Early adoption is permitted for reporting periods for which financial statements have not been issued. Aside from modifications pertaining to the acquisition of Allied World Switzerland's outstanding shares by Fairfax, the Company has historically not had modifications to its awards and does not expect for the adoption of ASU 2017-09 to have a material impact on its financial statements.

In August 2017, the FASB issued Accounting Standards Update 2017-12 “Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities” (“ASU 2017-12”). ASU 2017-12 permits hedge accounting for risk components in hedging relationships involving nonfinancial and interest rate risks for certain types of cash flow hedges. ASU 2017-12 is effective for annual periods beginning after December 15, 2018, including interim periods. Early application is permitted in any interim period after the issuance of the update. ASU 2017-12 modifies how entities designate fair value hedges of interest rate risk and also how they measure changes in fair value of hedged items in fair value hedges of interest rates. With regards to amounts excluded from hedge effectiveness, among other changes, ASU 2017-12 permits entities to exclude the portions of changes in fair values of currency swaps that are attributable to cross-currency basis spreads from the assessment of hedge effectiveness. In instances where quantitative testing of hedge effectiveness is required, after the initial quantitative testing, entities may perform subsequent assessments qualitatively, so long as they document on a quarterly basis that the facts and circumstances relating to the hedging relationships haven’t changed. ASU 2017-12 eliminates the requirement to disclose the ineffective portion of the changes in fair value of hedging instruments, but does create some new disclosure requirements pertaining to cash flow and fair value hedges. As the Company only utilizes economic hedging instruments and to date has not elected hedge accounting treatment for such instruments, it does not expect the adoption of ASU 2017-12 to have a material impact on its financial statements.

In September 2017, the FASB issued Accounting Standards Update 2017-13 “Revenue Recognition (Topic 605), Revenue from Contracts with Customers (Topic 606), Leases (Topic 840), and Leases (Topic 842): Amendments to SEC Paragraphs Pursuant to the Staff Announcement at the July 20, 2017 EITF Meeting and Rescission of Prior SEC Staff Announcements and Observer Comments” (“ASU 2017-13”). ASU 2017-13 allows for public business entities that otherwise would not meet the definition of public business entities but for a requirement to include or for the inclusion of their financial statements or financial information in another entities filing with the U.S. Securities and Exchange Commission, to adopt ASU 2014-09 (Topic 606) and ASU 2016-02 (Topic 842) according to the timelines for non-public entities. The Company will adopt ASU 2017-13 for reporting periods beginning January 1, 2019 for the Topic 606 updates and for reporting periods beginning January 1, 2020 for the Topic 842 updates. The Company does not expect ASU 2017-13 to have a material impact on its financial statements.

(Expressed in thousands of United States dollars, except share amounts)

3. INVESTMENTS

a) Other Invested Assets

Details regarding the carrying value, redemption characteristics and unfunded investment commitments of the other invested assets portfolio as of December 31, 2017 and 2016 were as follows:

Investment Type	Carrying Value as of December 31, 2017	Investments with Redemption Restrictions	Estimated Remaining Restriction Period	Investments without Redemption Restrictions	Redemption Frequency(1)	Redemption Notice Period(1)	Unfunded Commitments
Private equity	$ 156,141	$ 156,141	1 -14 Years	$ —			$ 106,159
Levered credit	134,466	134,466	2 - 8 Years	—			129,178
Real estate	177,123	177,123	5 -10 Years	—			89,935
Total private equity	467,730	467,730		—			325,272
Distressed	18,409	—		18,409	Quarterly	60 Days	—
Relative value credit	11,122	—		11,122	Quarterly	60 Days	—
Total hedge funds	29,531	—		29,531			—
Total other invested assets at fair value	497,261	467,730		29,531			325,272
Other private securities	45,572	—		45,572			—
Total other invested assets	$ 542,833	$ 467,730		$ 75,103			$ 325,272

Investment Type	Carrying Value as of December 31, 2016	Investments with Redemption Restrictions	Estimated Remaining Restriction Period	Investments without Redemption Restrictions	Redemption Frequency(1)	Redemption Notice Period(1)	Unfunded Commitments
Private equity	$ 280,978	$ 280,978	1 -15 Years	$ —			$ 219,300
Mezzanine debt	204,946	204,946	3 - 9 Years	—			190,800
Distressed	68,897	68,897	6 - 8 Years	—			191,600
Real estate	4,984	4,984	1 Year	—			3,800
Total private equity	559,805	559,805		—			605,500
Distressed	175,283	—		175,283	Quarterly	60 Days	—
Relative value credit	84,766	—		84,766	Quarterly	60 Days	—
Equity long/short	67,942	—		67,942	Quarterly	45 Days	—
Funds of funds	9,989	—		9,989	Quarterly	60 Days	—
Total hedge funds	337,980	—		337,980			—
Total other invested assets at fair value	897,785	559,805		337,980			605,500
Other private securities	60,525	—		60,525			—
Total other invested assets	$ 958,310	$ 559,805		$ 398,505			$ 605,500

(1) The redemption frequency and notice periods only apply to the investments without redemption restrictions.

In general, the Company has invested in hedge funds that require at least 30 days' notice of redemption, and may be redeemed on a monthly, quarterly, semi-annual, annual or longer basis, depending on the fund. Certain hedge funds have lock-up periods ranging from one to three years from initial investment. A lock-up period refers to the initial amount of time an investor is contractually required to invest before having the ability to redeem. Funds that provide for periodic redemptions may, depending on the funds' governing documents, have the ability to deny or delay a redemption request, called a "gate." The fund may implement this restriction because the aggregate amount of redemption requests as of a particular date exceeds a specified level, generally ranging from 15% to 25% of the fund's net assets. The gate is a method for executing an orderly redemption process to reduce the possibility of adversely affecting investors in the fund. Typically, the imposition of a gate delays a portion of the requested redemption, with the remaining portion settled in cash sometime after the redemption date. Certain funds may impose a redemption fee on early redemptions. Interests in private equity funds cannot be redeemed because the investments include restrictions that do not allow for redemption until termination of the fund.

The following describes each investment type:

- **Private equity (primary and secondary):** Primary equity funds include funds that may invest in companies and general partnership interests, as well as direct investments. Secondary funds buy limited partnership interests from existing limited partners of primary private equity funds. As owners of private equity, funds may seek liquidity by selling their existing interests, plus any remaining commitment, to secondary market participants. These funds cannot be redeemed because the investments include restrictions that do not allow for redemption until termination of the funds.

- **Levered credit (including mezzanine debt):** Levered credit funds invest across the capital structures of upper middle market and middle market companies in connection with leveraged buyouts, mergers and acquisitions, recapitalizations, growth financings, refinancings and other corporate purposes. The most common position in the capital structure of mezzanine funds will be between the senior secured debt holder and the equity; however, the funds in which we are invested may include secured debt, subordinated debt, preferred stock and/or private equity. These funds cannot be redeemed because the investments include restrictions that do not allow for redemption until termination of the funds.

- **Real estate funds:** Private real estate funds invest directly (through debt and equity) in commercial real estate (multifamily, industrial, office, student housing and retail) as well as residential property. Real estate managers have diversified portfolios that generally follow core, core-plus, value-added or opportunistic strategies. These funds cannot be redeemed because the investments include restrictions that do not allow for redemption until termination of the funds.

- **Distressed funds:** In distressed debt investing, managers take positions in the debt of companies experiencing significant financial difficulties, including bankruptcy, or in certain positions of the capital structure of structured securities. The manager relies on the fundamental analysis of these securities, including the claims on the assets and the likely return to bondholders. Certain funds cannot be redeemed because the investments include restrictions that do not allow for redemption until termination of the funds.

- **Relative value credit funds:** These funds seek to take exposure to credit-sensitive securities, long and/or short, based upon credit analysis of issuers and securities and credit market views.

- **Equity long/short funds:** In equity long/short funds, managers take long positions in companies they deem to be undervalued and short positions in companies they deem to be overvalued. Long/short managers may invest in countries, regions or sectors and vary by their use of leverage and by their targeted net long position.

- **Fund of funds:** Fund of funds allocate assets among multiple investment managers unaffiliated with the fund of funds sponsor employing a variety of proprietary investment strategies. Fund of funds strategies will invest in a portfolio of funds that primarily pursue the following investment strategies: equity, macro, event driven and credit.

- **Other private securities:** These securities mostly include strategic non-controlling minority investments in private asset management companies and other insurance related investments that are accounted for using the equity method of accounting.

(Expressed in thousands of United States dollars, except share amounts)

b) Net Investment Income

	Year Ended December 31,		
	2017	2016	2015
Fixed maturity investments	$ 137,886	$ 184,857	$ 159,681
Equity securities	3,732	5,110	13,333
Other invested assets: hedge funds and private equity	31,011	23,352	19,609
Other invested assets: other private securities	3,127	2,347	1,339
Cash and cash equivalents	11,140	2,350	1,078
Expenses	(20,674)	(16,954)	(19,747)
Net investment income	$ 166,222	$ 201,062	$ 175,293

c) Components of Realized Gains and Losses

	Year Ended December 31,		
	2017	2016	2015
Gross realized gains on sale of invested assets	$ 197,367	$ 137,070	$ 180,000
Gross realized losses on sale or impairment of invested assets	(164,419)	(117,493)	(105,416)
Net realized and unrealized losses on derivatives	(5,764)	(19,641)	(15,440)
Mark-to-market gains (losses):			
Debt securities, trading	84,540	(12,069)	(120,609)
Equity securities, trading	(8,137)	(2,328)	(41,726)
Other invested assets, trading	(97,790)	(5,110)	(18,137)
Net realized investment gains (losses)	$ 5,797	$ (19,571)	$ (121,328)

Gross realized losses on sale or impairment of invested assets for the year ended December 31, 2017 included a realized loss of $17,105 related to one of the Company's other private securities, which represented the carrying value of this investment. An impairment was recorded for this investment, who is an asset manager, because the investment was likely not to be a going concern as a result of assets under management being redeemed (including from the Company, which represented a substantial percentage of assets under management).

d) Pledged Assets

As of December 31, 2017 and 2016, $3,106,100 and $2,593,567, respectively, of cash and cash equivalents and investments were deposited, pledged or held in trust accounts in favor of ceding companies and other counterparties or government authorities to comply with reinsurance contract provisions and insurance laws.

In addition, as of December 31, 2017 and 2016, a further $646,983 and $587,634, respectively, of cash and cash equivalents and investments were pledged as collateral for the Company’s letter of credit facilities. See Note 9 for details on the Company’s credit facilities.

(Expressed in thousands of United States dollars, except share amounts)

4. DERIVATIVE INSTRUMENTS

As of December 31, 2017 and 2016, none of the Company's derivatives were designated as hedges for accounting purposes. The following table summarizes information on the location and amounts of derivative fair values on the consolidated balance sheets:

	December 31, 2017				December 31, 2016			
	Asset Derivative Notional Amount	Asset Derivative Fair Value	Liability Derivative Notional Amount	Liability Derivative Fair Value	Asset Derivative Notional Amount	Asset Derivative Fair Value	Liability Derivative Notional Amount	Liability Derivative Fair Value
Foreign exchange contracts	$ —	$ —	$ 105,669	$ 610	$ 103,210	$ 10,399	$ 4,111	$ 59
Insurance contracts	225,000	7,497	—	—	225,000	7,407	—	—
Reinsurance contracts	—	—	120,000	3,870	—	—	110,000	4,021
Total derivatives	$ 225,000	$ 7,497	$ 225,669	$ 4,480	$ 328,210	$ 17,806	$ 114,111	$ 4,080

Derivative assets and derivative liabilities are classified within "other assets" or "accounts payable and accrued liabilities" on the consolidated balance sheets.

The following table provides the net realized and unrealized gains (losses) on derivatives not designated as accounting hedges recorded on the consolidated income statements:

	Year Ended December 31,		
	2017	2016	2015
Foreign exchange contracts	$ 2,973	$ (2,225)	$ (7,284)
Total included in foreign exchange losses (gains)	2,973	(2,225)	(7,284)
Foreign exchange contracts	(552)	(11,917)	240
Interest rate futures and swaps	(5,214)	(7,724)	(15,680)
Total included in net realized investment (losses) gains	(5,766)	(19,641)	(15,440)
Insurance contracts	(294)	7,407	—
Reinsurance contracts	7,135	(3,137)	—
Total included in other income (expense)	6,841	4,270	—
Total realized and unrealized losses on derivatives	$ 4,048	$ (17,596)	$ (22,724)

The foreign exchange contracts loss recorded during the year ended December 31, 2016 was due to economic hedges of our investment exposure to the Euro and Japanese Yen.

Derivative Instruments Not Designated as Hedging Instruments

The Company is exposed to foreign currency risk in its investment portfolio. Accordingly, the fair values of the Company's investment portfolio are partially influenced by the change in foreign exchange rates. These foreign currency hedging activities have not been designated as specific hedges for financial reporting purposes.

The Company's insurance and reinsurance subsidiaries and branches operate in various foreign countries and consequently the Company's underwriting portfolio is exposed to foreign currency risk. The Company manages foreign currency risk by seeking to match liabilities under the insurance policies and reinsurance contracts that it writes and that are payable in foreign currencies with cash and investments that are denominated in such currencies. When necessary, the Company may also use derivatives to economically hedge unmatched foreign currency exposures, specifically forward contracts and currency options

The Company also purchases and sells interest rate future and interest rate swap contracts to actively manage the duration and yield curve positioning of its fixed income portfolio. Interest rate futures and interest rate swaps can efficiently increase or decrease the overall duration of the portfolio. Additionally, interest rate future and interest rate swap contracts can be utilized to obtain the desired position along the yield curve in order to protect against certain future yield curve shapes.

(Expressed in thousands of United States dollars, except share amounts)

The Company also purchases options to actively manage the Company's equity portfolio.

The Company also has entered into insurance and reinsurance contracts that are required to be accounted for as derivatives. This will be the case when the insurance or reinsurance contract provides indemnification to the insured or cedent as a result of a change in a variable versus an identifiable insurable event, such as a single-trigger ILW. The Company considers these insurance and reinsurance contracts to be an extension of its overall insurance operations.

5. FAIR VALUE OF FINANCIAL INSTRUMENTS

In accordance with U.S. GAAP, fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. There is a three-level valuation hierarchy for disclosure of fair value measurements. The valuation hierarchy is based upon whether the inputs to the valuation of an asset or liability are observable or unobservable in the market at the measurement date, with quoted market prices being the highest level (Level 1) and unobservable inputs being the lowest level (Level 3). A fair value measurement will fall within the level of the hierarchy based on the input that is significant to determining such measurement. The three levels are defined as follows:

- **Level 1**: Observable inputs to the valuation methodology that are quoted prices (unadjusted) for identical assets or liabilities in active markets.
- **Level 2**: Observable inputs to the valuation methodology other than quoted market prices (unadjusted) for identical assets or liabilities in active markets. Level 2 inputs include quoted prices for similar assets and liabilities in active markets, quoted prices for identical assets in markets that are not active and inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the asset or liability.
- **Level 3**: Inputs to the valuation methodology that are unobservable for the asset or liability.

The following table shows the fair value of the Company's financial instruments and where in the fair value hierarchy the fair value measurements are included as of the dates indicated below:

December 31, 2017	Carrying amount	Total Fair Value	Level 1	Level 2	Level 3
Fixed maturity investments:					
U.S. government and government agencies	$ 3,761,609	$ 3,761,609	$ 3,760,868	$ 741	$ —
Non-U.S. government and government agencies	380,247	380,247	—	380,247	—
States, municipalities and political subdivisions	81,709	81,709	—	81,709	—
Corporate debt	903,267	903,267	—	863,422	39,845
Asset-backed	65,759	65,759	—	—	65,759
Total fixed maturity investments	5,192,591	5,192,591	3,760,868	1,326,119	105,604
Equity securities	826,632	826,632	—	323,276	503,356
Other invested assets (1)	497,261	497,261	—	—	—
Total investments	$ 6,516,484	$ 6,516,485	$ 3,760,868	$ 1,649,395	$ 608,960
Derivative assets:					
Insurance contracts	$ 7,497	7,497	$ —	—	7,497
Derivative liabilities:					
Foreign exchange contracts	$ 610	$ 610	$ —	$ 610	$ —
Reinsurance contracts	3,870	3,870	—	—	3,870
Other long-term debt	$ 22,500	23,415	—	23,415	—

(Expressed in thousands of United States dollars, except share amounts)

December 31, 2016	Carrying amount	Total Fair Value	Level 1	Level 2	Level 3
Fixed maturity investments:					
U.S. government and government agencies	$ 1,287,103	$ 1,287,103	$ 1,246,744	$ 40,359	$ —
Non-U.S. government and government agencies	354,764	354,764	—	354,764	—
States, municipalities and political subdivisions	353,806	353,806	—	353,806	—
Corporate debt	2,356,273	2,356,273	—	2,354,773	1,500
Mortgage-backed	1,226,195	1,226,195	—	1,087,528	138,667
Asset-backed	725,463	725,463	—	665,947	59,516
Total fixed maturity investments	6,303,604	6,303,604	1,246,744	4,857,177	199,683
Equity securities	219,231	219,231	219,231	—	—
Other invested assets (1)	897,785	897,785	—	—	—
Total investments	$ 7,420,620	$ 7,420,620	$ 1,465,975	$ 4,857,177	$ 199,683
Derivative assets:					
Foreign exchange contracts	$ 10,399	$ 10,399	$ —	$ 10,399	$ —
Insurance contracts	7,407	7,407	$ —	—	7,407
Derivative liabilities:					
Foreign exchange contracts	$ 59	$ 59	$ —	$ 59	$ —
Reinsurance contracts	4,021	4,021	—	—	4,021

(1) In accordance with U.S. GAAP, other invested assets, excluding other private securities, are measured at fair value using the net asset value per share (or its equivalent) practical expedient and have not been classified in the fair value hierarchy.

The following describes the valuation techniques used by the Company to determine the fair value of financial instruments held as of the balance sheet date.

Fair Value of Financial Instruments

U.S. government and government agencies: Comprised primarily of bonds issued by the U.S. Treasury, the Federal Home Loan Bank, the Federal Home Loan Mortgage Corporation and the Federal National Mortgage Association. The fair values of the Company's U.S. government securities are based on quoted market prices in active markets and are included in the Level 1 fair value hierarchy. The Company believes the market for U.S. Treasury securities is an actively traded market given the high level of daily trading volume. The fair values of U.S. government agency securities are priced using the spread above the risk-free yield curve. As the yields for the risk-free yield curve and the spreads for these securities are observable market inputs, the fair values of U.S. government agency securities are included in the Level 2 fair value hierarchy.

Non-U.S. government and government agencies: Comprised of fixed income obligations of non-U.S. governmental entities. The fair values of these securities are based on prices obtained from international indices and are included in the Level 2 fair value hierarchy.

States, municipalities and political subdivisions: Comprised of fixed income obligations of U.S. domiciled state and municipality entities. The fair values of these securities are based on prices obtained from the new issue market, and are included in the Level 2 fair value hierarchy.

Corporate debt: Comprised of bonds issued by or loan obligations of corporations that are diversified across a wide range of issuers and industries. The fair values of corporate debt that are short-term are priced using spread above the LIBOR yield curve, and the fair value of corporate debt that are long-term are priced using the spread above the risk-free yield curve. The spreads are sourced from broker-dealers, trade prices and the new issue market. As the significant inputs used to price corporate bonds are observable market inputs, the fair values of corporate debt are included in the Level 2 fair value hierarchy, unless the significant inputs used to price the corporate debt securities are broker-dealer quotes and the Company is not able to determine if those quotes are based on observable market inputs, in which case the fair value is included in the Level 3 hierarchy.

Mortgage-backed: Primarily comprised of residential and commercial mortgages originated by both U.S. government agencies (such as the Federal National Mortgage Association) and non-U.S. government agencies. The fair values of mortgage-backed securities originated by U.S. government agencies and non-U.S. government agencies are based on a pricing model that incorporates prepayment speeds and spreads to determine appropriate average life of mortgage-backed securities. The spreads are sourced from broker-dealers, trade prices and the new issue market. As the significant inputs used to price the mortgage-backed securities are observable market inputs, the fair values of these securities are included in the Level 2 fair value hierarchy, unless the significant inputs used to price the mortgage-backed securities are broker-dealer quotes and the Company is not able to determine if those quotes are based on observable market inputs, in which case the fair value is included in the Level 3 hierarchy.

Asset-backed: Principally comprised of bonds backed by pools of automobile loan receivables, home equity loans, credit card receivables and collateralized loan obligations originated by a variety of financial institutions. The fair values of asset-backed securities are priced using prepayment speed and spread inputs that are sourced from the new issue market or broker-dealer quotes. As the significant inputs used to price the asset-backed securities are observable market inputs, the fair values of these securities are included in the Level 2 fair value hierarchy, unless the significant inputs used to price the asset-backed securities are broker-dealer quotes and the Company is not able to determine if those quotes are based on observable market inputs, in which case the fair value is included in the Level 3 hierarchy.

Equity securities: Comprised of U.S. and foreign common and preferred stocks and mutual funds. Equities are generally included in the Level 1 fair value hierarchy as prices are obtained from market exchanges in active markets. The Company's remaining equity interest in an equity security that it no longer accounts for under the equity method of accounting is included in the Level 3 fair value hierarchy as the fair value is based on the enterprise value of that security which is not a publicly traded company. Also, subsequent to the Company being acquired by Fairfax, the Company has acquired certain securities that are valued by Fairfax by using unobservable inputs, and as such these securities have been included in the Level 3 fair value hierarchy.

Other invested assets: Comprised of funds invested in a range of diversified strategies. In accordance with U.S. GAAP, the fair values of the funds are based on the net asset value of the funds as reported by the fund manager. The Company does not measure its investments that are accounted for using the equity method of accounting at fair value, unless an other-than-temporary impairment is recorded.

Derivative instruments: The fair value of foreign exchange contracts and interest rate futures and swaps are priced from quoted market prices for similar exchange-traded derivatives and pricing valuation models that utilize independent market data inputs. The fair value of foreign exchange contracts and interest futures and swaps are included in the Level 2 fair value hierarchy. The fair value of the insurance and reinsurance contracts are based on an internal model that estimates the expected value based on multiple scenarios (i.e., Monte-Carlo simulation) and discounted back to current value. The key unobservable inputs are the discount rate, which was 10%, and the values of the underlying insured risks. Given the inputs to the internal model are unobservable, the fair value of the insurance and reinsurance contracts are included in the Level 3 fair value hierarchy.

Other long-term debt: Comprised of the external surplus note. The fair value of the other long-term debt is based on the value of the debt using current interest rates. The fair value of the long-term debt is included in the Level 2 fair value hierarchy. See note 9 for additional information.

Non-recurring Fair Value of Financial Instruments

The Company measures the fair value of certain assets on a non-recurring basis, generally quarterly, annually, or when events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. These assets include investments accounted for using the equity method, goodwill and intangible assets. The Company uses a variety of techniques to measure the fair value of these assets when appropriate, as described below:

Investments accounted for using the equity method: When the Company determines that the carrying value of these assets may not be recoverable, the Company records the assets at fair value with the loss recognized in income. In such cases, the Company measures the fair value of these assets using the techniques discussed above.

(Expressed in thousands of United States dollars, except share amounts)

Goodwill and intangible assets: The Company tests goodwill and intangible assets for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable, but at least annually for goodwill and indefinite-lived intangibles. When the Company determines that goodwill and indefinite-lived intangible assets may be impaired, the Company uses various techniques, including discounted expected future cash flows and market multiple models, to measure fair value.

Rollforward of Level 3 Financial Instruments

The following is a rollforward of the beginning and ending balance of financial instruments using significant unobservable inputs (Level 3):

	Mortgage-backed	Asset-backed	Equities	Corporate Debt	Insurance contracts	Reinsurance contracts
Year Ended December 31, 2017						
Opening balance	$ 138,667	$ 59,516	$ —	$ 1,500	$ 7,407	$ (4,021)
Realized and unrealized gains (losses) included in net income	(11,588)	(11,480)	9,188	1,039	76	149
Purchases	2,254	58,524	495,018	38,286	—	—
Sales	(129,333)	(64,583)	(850)	(980)	—	—
Transfers into Level 3 from Level 1 and 2 [(1)]	—	23,782	—	—	—	—
Ending balance	$ —	$ 65,759	$ 503,356	$ 39,845	$ 7,483	$ (3,872)
Realized and unrealized gains (losses) included in net income for investments still held as of December 31, 2017	$ —	$ 5,738	$ 8,338	$ 2,361	$ 76	$ 149

[(1)] Transfers into Level 3 from Level 1 and 2 are primarily attributable to the availability, or lack thereof, of market observable information.

The Company attempts to verify the significant inputs used by broker-dealers in determining the fair value of the securities priced by them. If the Company could not obtain sufficient information to determine if the broker-dealers were using significant observable inputs, such securities have been transferred to the Level 3 fair value hierarchy. The Company believes the prices obtained from the broker-dealers are the best estimate of fair value of the securities being priced as the broker-dealers are typically involved in the initial pricing of the security, and the Company has compared the price per the broker-dealer to other pricing sources and noted no material differences. The Company recognizes transfers between levels at the end of the reporting period. There were no transfers between Level 1 and Level 2 during the period.

The Company's external investment accounting service provider receives prices from internationally recognized independent pricing services to measure the fair values of its fixed maturity investments. Pricing sources are evaluated and selected in a manner to ensure that the most reliable sources are used. The independent pricing sources obtain market quotations and actual transaction prices for securities that have quoted prices in active markets. Each pricing service has its own proprietary method for determining the fair value of securities that are not actively traded. In general, these methods involve the use of "matrix pricing" in which the independent pricing service uses observable market inputs, including, but not limited to, reported trades, benchmark yields, broker-dealer quotes, interest rates, prepayment speeds, default rates and such other inputs as are available from market sources to determine a reasonable fair value.

All of the Company's fixed maturity investment securities classified as Level 3 are valued based on unadjusted broker-dealer quotes. This includes less liquid securities such as lower quality asset-backed securities, commercial mortgage-backed securities and residential mortgage-backed securities. The primary valuation inputs include monthly payment information, the probability of default, loss severity rates and estimated prepayment rates. Significant changes in these inputs in isolation would result in a significantly lower or higher fair value measurement. In general, a change in the assumption of the probability of default is accompanied by a directionally similar change in the assumption used for the loss severity in an event of default and prepayment rates.

The Company records the unadjusted price provided and validates this price through a process that includes, but is not limited to monthly and/or quarterly: (i) comparison of prices between two independent sources, with significant differences requiring additional price sources; (ii) quantitative analysis (e.g., comparing the quarterly return for each managed portfolio to their target benchmark, with significant differences identified and investigated); (iii) evaluation of methodologies used by external parties to calculate fair value, including a review of the inputs used for pricing; (iv) comparing the price to the Company's knowledge of the current investment market; and (v) back-testing, which includes randomly selecting purchased or sold securities and comparing the executed prices to the fair value estimates from the pricing service. In addition to internal controls, management relies on the effectiveness of the valuation controls in place at the Company’s external investment accounting service provider (supported by a Service Organization Controls Report, commonly referred to as a "SOC 1 Report") in conjunction with regular discussion and analysis of the investment portfolio’s structure and performance.

6. RESERVE FOR LOSSES AND LOSS EXPENSES

a) Basis for estimating the reserves for losses and loss expenses

The reserve for losses and loss expenses is comprised of two main elements: outstanding loss reserves (“OSLR,” also known as case reserves) and reserves for losses incurred but not reported (“IBNR”). OSLR relate to known claims and represent management’s best estimate of the likely loss settlement. IBNR reserves relate primarily to unreported events that, based on industry information, management’s experience and actuarial evaluation, can reasonably be expected to have occurred and are reasonably likely to result in a loss to the Company. IBNR reserves also relate to estimated development of reported events that based on industry information, management’s experience and actuarial evaluation, can reasonably be expected to reach the Company’s attachment point and are reasonably likely to result in a loss. The Company also includes in IBNR reserves changes in the values of claims that have been reported but are not yet settled. Each claim is settled individually based upon its merits and it is not unusual for a claim to take years after being reported to settle, especially if legal action is involved. As a result, reserves for losses and loss expenses include significant estimates for IBNR reserves.

The reserve for IBNR is estimated by management for each line of business based on various factors, including underwriters’ expectations about loss experience, actuarial analysis, comparisons with the results of industry benchmarks and loss experience to date. The Company implicitly factors into IBNR reserves inflation by assuming an inflation rate consistent with historical trends. The IBNR reserves are calculated as the ultimate amount of losses and loss expenses less cumulative paid losses and loss expenses and OSLR. The Company’s actuaries employ generally accepted actuarial methodologies to determine estimated ultimate loss reserves.

The Company believes that its current estimates of liabilities appropriately reflect its current knowledge of the business and the prevailing market, social, legal and economic conditions while giving due consideration to historical trends and volatility evidenced in the liabilities over the longer term. Although management believes that OSLR and the IBNR reserves are sufficient to cover losses assumed by the Company, there can be no assurance that losses will not deviate from the Company’s reserves, possibly by material amounts. The methodology of estimating loss reserves is periodically reviewed to ensure that the assumptions made continue to be appropriate. The Company recognizes any changes in its loss reserve estimates, including prior year loss reserve development, and the related reinsurance recoverables in the periods in which they are determined and are recorded in “net losses and loss expenses” in the consolidated income statements.

The reserve for losses and loss expenses consists of the following:

	December 31,	
	2017	**2016**
Outstanding loss reserves	$ 2,044,111	$ 1,690,271
Reserves for losses incurred but not reported	5,126,358	4,565,356
Reserve for losses and loss expenses	$ 7,170,469	$ 6,255,627

b) Reserve for losses and loss expenses rollforward

The table below is a reconciliation of the beginning and ending liability for unpaid losses and loss expenses. Losses incurred and paid are reflected net of reinsurance recoverables.

(Expressed in thousands of United States dollars, except share amounts)

	Year Ended December 31,		
	2017	2016	2015
Gross liability at beginning of year	$ 6,255,627	$ 6,184,156	$ 5,707,570
Reinsurance recoverable at beginning of year	(1,550,459)	(1,428,811)	(1,305,110)
Net liability at beginning of year	4,705,168	4,755,345	4,402,460
Acquisition of net reserves for losses and loss expenses	—	—	259,347
Net losses incurred related to:			
Current year	1,759,086	1,449,642	1,530,990
Prior years	71,852	(109,830)	(71,588)
Total incurred	1,830,938	1,339,812	1,459,402
Net paid losses related to:			
Current year	230,418	231,450	180,160
Prior years	1,197,068	1,147,384	1,170,147
Total paid	1,427,486	1,378,834	1,350,307
Foreign exchange revaluation and other	10,908	(11,155)	(15,557)
Net liability at end of year	5,119,528	4,705,168	4,755,345
Reinsurance recoverable at end of year	2,050,941	1,550,459	1,428,811
Gross liability at end of year	$ 7,170,469	$ 6,255,627	$ 6,184,156

For the year ended December 31, 2017, the Company recorded net unfavorable prior year reserve development primarily related to higher than expected claims development within the professional liability line of business for the 2012 and 2013 accident years. This was partially offset by net favorable prior year reserve development in the casualty reinsurance and specialty reinsurance lines of business. Also, during the year ended December 31, 2017, the Company incurred net losses, before reinstatement premiums, of $506,773 in catastrophe-related losses. The net losses incurred from Hurricane Harvey, Hurricane Irma, Hurricane Maria, earthquakes in Mexico, Typhoon Hato, Cyclone Debbie and the wildfires in Southern California and Northern California were $116,568, $137,115, $113,492, $9,135, $33,980, $9,415, $47,800 and $39,268, respectively.

For the year ended December 31, 2016, the Company recorded net favorable prior year reserve development in each of its operations, primarily due to actual loss emergence being lower than initially expected. The net favorable prior year reserve development in the Insurance operations were primarily related to the professional liability line of business. The net favorable prior year reserve development in the Reinsurance operations was primarily related to our property reinsurance and specialty reinsurance lines of business, partially offset by net unfavorable prior year reserve development in our casualty reinsurance line of business.

For the year ended December 31, 2015, the Company recognized net favorable prior year reserve development primarily due to lower than expected loss emergence in the Reinsurance operations and net unfavorable prior year reserve development in the Insurance operations. The net favorable reserve development in the Reinsurance operations was primarily related to the property and casualty reinsurance lines of business. The net unfavorable prior year reserve development for the Insurance operations primarily related to net unfavorable prior year development in the healthcare and casualty lines of business mainly from the 2012 through 2014 loss years partially offset by favorable prior year reserve development in the professional liability, programs and property lines of business.

The Company has not accrued any additional premiums or return premiums as a result of the net prior year reserve development during the years ended December 31, 2017, 2016 and 2015.

Although the Company has historically experienced favorable and unfavorable development in its insurance and reinsurance lines, there is no assurance that conditions and trends that have affected the development of liabilities in the past will continue. It is not appropriate to extrapolate future redundancies based on prior years' development. The methodology of estimating loss reserves is periodically reviewed to ensure that the key assumptions used in the actuarial models continue to be appropriate.

c) Incurred and Paid Loss Development Triangles

The following information presents the incurred and paid claims information as of December 31, 2017, net of reinsurance, as well as cumulative claim frequency and total IBNR reserves by accident year. The information about incurred and paid claims development presented for the years ended December 31, 2010 to December 31, 2016 is presented as supplementary information.

The incurred and paid loss development triangles are presented based on the following:

i. Groupings

Disaggregated based on lines of business within each operation. There are a total of 11 incurred and paid loss development triangles presented, of which eight relate to the Insurance operation and three relate to the Reinsurance operation. The 11 incurred and paid loss development triangles were selected to create categories that were relatively homogeneous yet were not so small as to have insufficient actuarial credibility, and are consistent with how the Company discloses gross premiums written and net premiums earned by line of business, as well as disaggregated to reflect the reserves acquired from the Hong Kong, Singapore and Labuan branches of RSA in 2015 on a prospective basis. The Company has lines of business that are 100% ceded that are not presented in the incurred and paid loss development triangles.

ii. Presentation

All incurred and paid loss development triangles are presented net of reinsurance and excludes unallocated loss adjustment expenses, allowance for uncollectible reinsurance recoverables, currency translation adjustments and fair value adjustments related to acquired reserves as those balances are not estimated for each accident year.

The incurred and paid loss development triangles include eight years of historical information. The Company has determined that it is impractical to provide incurred and paid loss development information at this disaggregated basis prior to accident year 2010 as all the necessary data prior to 2010 was not maintained at this disaggregated level.

Acquisitions will be presented in the incurred and paid loss development triangles based on how the acquired reserves impact the nature, amount, timing and uncertainty of the cash flows related the settlement of the reserve for losses and loss expenses. As it relates to the reserves for losses and loss expenses acquired from RSA, those reserves are presented from the date in which they were acquired (April 1, 2015) as separate incurred and paid loss development triangles until such time when it is appropriate to combine with the equivalent Insurance operation incurred and paid loss development triangles. The Company has made changes to how reserves are settled and estimated, and therefore the incurred and paid development information prior to the acquisition will no longer provide relevant information regarding the nature, amount, timing and uncertainty of how these reserves will settle in the future. Also, the Company does not have sufficient information at this disaggregated level to present the Insurance operation incurred and paid loss development triangles on a retrospective basis, including the incurred and paid information from the acquired RSA reserves.

iii. Foreign exchange

Reserves for losses and loss expenses and paid losses that are not recorded in the United States dollar functional currency are revalued at the United States dollar conversion rate at the end of the period.

iv. IBNR

The 'Total IBNR' by accident year disclosed with the incurred and paid loss development triangles includes (1) IBNR reserves for unreported events and (2) changes in the values of claims that have been reported but are not yet settled.

v. Claim count

Cumulative reported claims included in the tables below, which are reflected as the actual claim counts shown, consist of any reported indemnity claim or expense by claimant (e.g., insured) as of December 31, 2017 with a reserve balance greater than one United States dollar (or equivalent foreign currency). By including only claims with reserves greater than one United

(Expressed in thousands of United States dollars, except share amounts)

States dollar (or equivalent foreign currency), the tables do not include any notifications of claims, which may or may not result in an indemnity claim. The cumulative claim count information for the acquired RSA operations are higher, on a relative basis, than the other lines of business cumulative claim count information as the acquired RSA operations have a higher percentage of retail business. This will result in reporting, on average, higher frequency of reported claims with lower severity per claim. The Company has determined that it is impractical to provide cumulative reported claim information for the lines of business in the Reinsurance operation as this information is not provided to the Company from the cedents. The Company also does not believe cumulated reported claim counts for its Reinsurance operation provides any meaningful information related to the nature, amount, timing and uncertainty of the cash flows related to the settled of the reserve for losses and loss expenses.

Insurance Operation:

Casualty - Excluding RSA acquired reserves

Incurred Claims and Loss Adjustment Expenses, Net of Reinsurance

									As of December 31, 2017	
Accident Year	Unaudited 2010	Unaudited 2011	Unaudited 2012	Unaudited 2013	Unaudited 2014	Unaudited 2015	Unaudited 2016	2017	**Total IBNR**	**Cumulative Reported Claims**
2010	$ 147,954	$ 170,982	$ 172,607	$ 165,335	$ 159,645	$ 149,329	$ 131,510	$ 131,650	$ 25,451	281
2011		130,040	149,860	160,041	159,438	152,363	159,624	166,674	28,186	356
2012			152,408	155,751	158,242	173,596	194,077	216,383	32,786	419
2013				190,678	199,021	215,179	243,035	241,934	72,091	660
2014					244,915	228,049	238,320	268,112	58,910	811
2015						292,943	284,823	283,725	148,419	856
2016							272,656	257,276	178,509	993
2017								251,098	218,665	719
								$ 1,816,852		

Cumulative Paid Claims and Loss Adjustment Expenses, Net of Reinsurance

Accident Year	Unaudited 2010	Unaudited 2011	Unaudited 2012	Unaudited 2013	Unaudited 2014	Unaudited 2015	Unaudited 2016	2017
2010	$ 626	$ 28,426	$ 65,882	$ 72,909	$ 83,086	$ 87,436	$ 96,944	$ 105,245
2011		2,127	11,425	33,128	63,092	89,112	101,926	120,234
2012			6,454	25,872	53,189	85,430	114,533	157,253
2013				9,733	38,612	70,231	103,720	153,448
2014					8,557	58,429	104,102	165,580
2015						11,357	35,887	85,747
2016							10,010	40,622
2017								10,870
								$ 838,999
All outstanding liabilities before 2010, net of reinsurance								$ 92,841
Liability for losses and loss expenses, net of reinsurance								$ 1,070,695

(Expressed in thousands of United States dollars, except share amounts)

Casualty - RSA acquired reserves

Incurred Claims and Loss Adjustment Expenses, Net of Reinsurance

									As of December 31, 2017	
Accident Year	Unaudited 2010	Unaudited 2011	Unaudited 2012	Unaudited 2013	Unaudited 2014	Unaudited 2015	Unaudited 2016	2017	Total IBNR	Cumulative Reported Claims
2010	$ —	$ —	$ —	$ —	$ —	$ 3,241	$ 2,702	$ 1,713	$ 2	92
2011		—	—	—	—	7,211	6,174	5,729	—	252
2012			—	—	—	19,279	17,809	17,772	167	403
2013				—	—	53,589	43,270	43,361	1,110	931
2014					—	99,503	68,921	72,408	4,602	2,387
2015						99,444	78,641	76,506	5,705	5,366
2016							61,584	60,391	8,056	6,714
2017								38,111	9,899	5,014
								$ 315,991		

Cumulative Paid Claims and Loss Adjustment Expenses, Net of Reinsurance

Accident Year	Unaudited 2010	Unaudited 2011	Unaudited 2012	Unaudited 2013	Unaudited 2014	Unaudited 2015	Unaudited 2016	2017
2010	$ —	$ —	$ —	$ —	$ —	$ 1,050	$ 1,459	$ 1,447
2011		—	—	—	—	2,705	4,724	5,124
2012			—	—	—	8,163	14,184	16,062
2013				—	—	13,232	28,109	36,714
2014					—	16,758	37,188	51,567
2015						12,208	31,557	48,028
2016							13,623	28,865
2017								9,796
								$ 197,603
All outstanding liabilities before 2010, net of reinsurance								$ 547
Liability for losses and loss expenses, net of reinsurance								$ 118,935

(Expressed in thousands of United States dollars, except share amounts)

Professional liability

Incurred Claims and Loss Adjustment Expenses, Net of Reinsurance

									As of December 31, 2017	
Accident Year	Unaudited 2010	Unaudited 2011	Unaudited 2012	Unaudited 2013	Unaudited 2014	Unaudited 2015	Unaudited 2016	2017	**Total IBNR**	**Cumulative Reported Claims**
2010	$ 300,234	$ 305,139	$ 302,025	$ 287,987	$ 253,831	$ 233,118	$ 230,92	$ 231,004	$ 29,687	551
2011		299,029	322,220	350,116	368,067	350,840	345,285	343,804	30,409	831
2012			310,403	385,108	408,546	423,201	416,043	474,475	87,610	1,080
2013				327,297	358,739	369,582	384,150	393,980	80,586	1,447
2014					312,980	343,794	333,506	333,898	89,963	1,366
2015						357,608	363,802	361,769	170,669	1,546
2016							327,484	336,642	213,329	1,218
2017								273,372	247,529	317
								$ 2,748,944		

Cumulative Paid Claims and Loss Adjustment Expenses, Net of Reinsurance

Accident Year	Unaudited 2010	Unaudited 2011	Unaudited 2012	Unaudited 2013	Unaudited 2014	Unaudited 2015	Unaudited 2016	2017
2010	$ 9,098	$ 42,921	$ 74,277	$ 107,503	$ 133,900	$ 149,912	$ 179,52	$ 187,351
2011		14,134	67,520	152,426	203,470	246,138	289,261	296,617
2012			17,230	79,452	143,107	215,207	280,722	336,438
2013				12,323	63,447	154,996	231,096	270,546
2014					13,111	78,270	138,196	185,417
2015						10,581	73,671	132,132
2016							12,208	67,028
2017								9,341
								$ 1,484,870
All outstanding liabilities before 2010, net of reinsurance								$ 130,673
Liability for losses and loss expenses, net of reinsurance								$ 1,394,747

(Expressed in thousands of United States dollars, except share amounts)

Property - Excluding RSA acquired reserves

Incurred Claims and Loss Adjustment Expenses, Net of Reinsurance

Accident Year	Unaudited 2010	Unaudited 2011	Unaudited 2012	Unaudited 2013	Unaudited 2014	Unaudited 2015	Unaudited 2016	2017	As of December 31, 2017 Total IBNR	As of December 31, 2017 Cumulative Reported Claims
2010	$ 152,096	$ 155,369	$ 146,902	$ 144,215	$ 144,167	$ 145,286	$ 142,51	$ 142,074	$ 679	560
2011		167,370	166,821	158,021	152,938	151,882	150,324	150,214	56	568
2012			161,217	149,347	143,180	138,007	138,232	138,008	76	676
2013				88,307	80,268	72,698	72,105	71,954	174	976
2014					105,174	103,392	95,131	94,622	817	1,391
2015						116,963	118,191	120,048	1,637	1,495
2016							107,617	113,460	(6,452)	1,977
2017								230,285	44,755	2,464
								$ 1,060,665		

Cumulative Paid Claims and Loss Adjustment Expenses, Net of Reinsurance

Accident Year	Unaudited 2010	Unaudited 2011	Unaudited 2012	Unaudited 2013	Unaudited 2014	Unaudited 2015	Unaudited 2016	2017
2010	$ 65,695	$ 110,536	$ 125,329	$ 136,548	$ 139,594	$ 140,488	$ 141,07	$ 141,445
2011		35,739	91,905	131,308	146,251	147,783	149,293	149,620
2012			21,176	97,790	126,469	134,306	136,226	137,062
2013				26,767	58,372	66,993	70,223	70,839
2014					35,041	77,285	89,297	90,764
2015						53,192	100,877	113,458
2016							47,218	89,656
2017								62,468
								$ 855,312
All outstanding liabilities before 2010, net of reinsurance								$ 1,978
Liability for losses and loss expenses, net of reinsurance								$ 207,331

The incurred losses and IBNR recorded for accident year 2017 was primarily driven by the catastrophe losses incurred during the second half of 2017.

(Expressed in thousands of United States dollars, except share amounts)

Property - RSA acquired reserves

Incurred Claims and Loss Adjustment Expenses, Net of Reinsurance

Accident Year	Unaudited 2010	Unaudited 2011	Unaudited 2012	Unaudited 2013	Unaudited 2014	Unaudited 2015	Unaudited 2016	2017	As of December 31, 2017 Total IBNR	Cumulative Reported Claims
2010	$ —	$ —	$ —	$ —	$ —	$ (9)	$ 71	$ 72	$ —	47
2011		—	—	—	—	983	528	496	—	107
2012			—	—	—	1,840	1,537	1,584	—	203
2013				—	—	4,467	4,725	4,386	2	464
2014					—	14,892	15,288	14,706	17	1,207
2015						23,407	12,724	12,430	(15)	3,788
2016							21,822	25,025	10,191	2,795
2017								20,556	19,150	1,911
								$ 79,255		

Cumulative Paid Claims and Loss Adjustment Expenses, Net of Reinsurance

Accident Year	Unaudited 2010	Unaudited 2011	Unaudited 2012	Unaudited 2013	Unaudited 2014	Unaudited 2015	Unaudited 2016	2017
2010	$ —	$ —	$ —	$ —	$ —	$ 96	$ 50	$ 58
2011		—	—	—	—	225	666	953
2012			—	—	—	570	1,417	1,433
2013				—	—	1,742	3,265	3,424
2014					—	6,851	10,325	13,080
2015						2,995	8,625	10,244
2016							2,018	9,351
2017								85
								$ 38,628
All outstanding liabilities before 2010, net of reinsurance								$ 313
Liability for losses and loss expenses, net of reinsurance								$ 40,940

(Expressed in thousands of United States dollars, except share amounts)

Programs

Incurred Claims and Loss Adjustment Expenses, Net of Reinsurance

Accident Year	Unaudited 2010	Unaudited 2011	Unaudited 2012	Unaudited 2013	Unaudited 2014	Unaudited 2015	Unaudited 2016	2017	As of December 31, 2017 Total IBNR	As of December 31, 2017 Cumulative Reported Claims
2010	$ 70,690	$ 72,488	$ 86,418	$ 80,832	$ 78,840	$ 75,489	$ 75,007	$ 74,471	$ 1,556	481
2011		54,013	61,888	62,553	58,057	52,541	53,455	51,874	2,630	444
2012			56,681	60,456	62,367	59,470	58,733	58,925	4,878	494
2013				64,938	61,961	59,899	56,336	53,887	8,123	868
2014					74,866	73,874	69,989	67,709	19,374	1,150
2015						86,848	86,208	81,916	34,193	1,262
2016							113,628	114,642	54,566	1,511
2017								147,669	92,430	1,856
								$ 651,093		

Cumulative Paid Claims and Loss Adjustment Expenses, Net of Reinsurance

Accident Year	Unaudited 2010	Unaudited 2011	Unaudited 2012	Unaudited 2013	Unaudited 2014	Unaudited 2015	Unaudited 2016	2017
2010	$ 2,915	$ 17,867	$ 42,418	$ 52,271	$ 59,869	$ 64,436	$ 66,299	$ 64,754
2011		3,764	15,206	26,749	34,742	41,267	45,323	47,123
2012			3,842	17,568	29,635	38,325	44,478	48,084
2013				5,738	15,790	24,361	32,985	40,035
2014					6,425	16,864	27,470	39,326
2015						9,324	26,322	37,337
2016							14,128	43,840
2017								22,149
								$ 342,648
All outstanding liabilities before 2010, net of reinsurance								$ 7,415
Liability for losses and loss expenses, net of reinsurance								$ 312,860

(Expressed in thousands of United States dollars, except share amounts)

Other specialty - Excluding RSA acquired reserves

Incurred Claims and Loss Adjustment Expenses, Net of Reinsurance

Accident Year	Unaudited 2010	Unaudited 2011	Unaudited 2012	Unaudited 2013	Unaudited 2014	Unaudited 2015	Unaudited 2016	2017	As of December 31, 2017 Total IBNR	As of December 31, 2017 Cumulative Reported Claims
2010	$ 963	$ 920	$ 920	$ 694	$ 466	$ 316	$ 414	$ 513	$ 58	11
2011		17,487	19,927	19,329	18,683	18,681	18,738	18,639	682	21
2012			25,446	25,464	24,331	23,108	23,043	22,951	2,029	24
2013				23,471	32,454	37,098	36,675	45,257	5,443	176
2014					55,583	69,460	81,536	76,448	10,977	698
2015						76,352	81,614	83,956	26,419	690
2016							107,236	109,584	47,099	1,234
2017								129,543	103,812	1,290
								$ 486,891		

Cumulative Paid Claims and Loss Adjustment Expenses, Net of Reinsurance

Accident Year	Unaudited 2010	Unaudited 2011	Unaudited 2012	Unaudited 2013	Unaudited 2014	Unaudited 2015	Unaudited 2016	2017
2010	$ 4	$ 23	$ 34	$ 80	$ 87	$ 92	$ 364	$ 374
2011		4,050	11,226	14,464	15,095	15,901	16,724	17,728
2012			486	10,313	16,314	19,284	19,702	20,054
2013				953	7,226	20,265	23,234	26,897
2014					12,926	37,364	48,319	59,685
2015						14,637	36,806	46,317
2016							25,284	44,980
2017								13,407
								$ 229,442
All outstanding liabilities before 2010, net of reinsurance								$ —
Liability for losses and loss expenses, net of reinsurance								$ 257,449

(Expressed in thousands of United States dollars, except share amounts)

Other specialty - RSA acquired reserves

Incurred Claims and Loss Adjustment Expenses, Net of Reinsurance

Accident Year	Unaudited 2010	Unaudited 2011	Unaudited 2012	Unaudited 2013	Unaudited 2014	Unaudited 2015	Unaudited 2016	2017	As of December 31, 2017 Total IBNR	As of December 31, 2017 Cumulative Reported Claims
2010	$ —	$ —	$ —	$ —	$ —	$ 1,151	$ 1,173	$ 1,178	$ 1	104
2011		—	—	—	—	1,336	2,685	2,621	1	216
2012			—	—	—	2,503	2,699	2,488	—	375
2013				—	—	7,419	7,284	6,880	63	816
2014					—	21,654	23,010	20,825	(205)	2,600
2015						40,799	43,654	42,635	324	13,608
2016							32,394	37,811	8,831	16,595
2017								54,327	25,145	11,864
								$ 168,765		

Cumulative Paid Claims and Loss Adjustment Expenses, Net of Reinsurance

Accident Year	Unaudited 2010	Unaudited 2011	Unaudited 2012	Unaudited 2013	Unaudited 2014	Unaudited 2015	Unaudited 2016	2017
2010	$ —	$ —	$ —	$ —	$ —	$ 89	$ 296	$ 600
2011		—	—	—	—	315	874	1,303
2012			—	—	—	387	1,487	1,808
2013				—	—	2,282	3,370	4,487
2014					—	5,759	10,478	12,878
2015						7,518	20,130	28,594
2016							6,946	13,252
2017								6,478
								$ 69,400
All outstanding liabilities before 2010, net of reinsurance								$ 223
Liability for losses and loss expenses, net of reinsurance								$ 99,588

(Expressed in thousands of United States dollars, except share amounts)

Reinsurance Operation:

Property

Incurred Claims and Loss Adjustment Expenses, Net of Reinsurance

									As of December 31, 2017	
Accident Year	Unaudited 2010	Unaudited 2011	Unaudited 2012	Unaudited 2013	Unaudited 2014	Unaudited 2015	Unaudited 2016	2017	Total IBNR	Cumulative Reported Claims
2010	$ 75,215	$ 77,551	$ 72,288	$ 67,780	$ 67,094	$ 67,140	$ 65,968	$ 65,127	$ 405	n/a
2011		183,079	187,920	177,926	171,928	170,923	171,711	172,636	915	n/a
2012			150,345	119,866	112,232	110,559	107,865	107,708	2,119	n/a
2013				91,562	62,286	58,041	53,923	53,368	442	n/a
2014					134,599	118,374	110,664	109,665	854	n/a
2015						129,462	107,808	99,541	1,064	n/a
2016							116,243	118,828	4,510	n/a
2017								297,004	135,293	n/a
								$ 1,023,877		

Cumulative Paid Claims and Loss Adjustment Expenses, Net of Reinsurance

Accident Year	Unaudited 2010	Unaudited 2011	Unaudited 2012	Unaudited 2013	Unaudited 2014	Unaudited 2015	Unaudited 2016	2017
2010	$ 11,114	$ 38,770	$ 50,566	$ 57,186	$ 62,127	$ 63,761	$ 64,194	$ 63,835
2011		48,220	101,098	144,817	159,338	165,594	168,075	170,000
2012			35,286	78,676	92,424	96,842	99,527	102,006
2013				20,006	43,513	50,131	51,820	53,147
2014					51,133	86,669	98,108	102,954
2015						47,017	78,907	93,372
2016							45,455	91,015
2017								63,721
								$ 740,050
All outstanding liabilities before 2010, net of reinsurance								$ 1,317
Liability for losses and loss expenses, net of reinsurance								$ 285,144

The incurred losses and IBNR recorded for accident year 2017 was primarily driven by the catastrophe losses incurred during the second half of 2017.

(Expressed in thousands of United States dollars, except share amounts)

Casualty

Incurred Claims and Loss Adjustment Expenses, Net of Reinsurance

Accident Year	Unaudited 2010	Unaudited 2011	Unaudited 2012	Unaudited 2013	Unaudited 2014	Unaudited 2015	Unaudited 2016	2017	As of December 31, 2017 Total IBNR	As of December 31, 2017 Cumulative Reported Claims
2010	$ 201,913	$ 222,456	$ 226,654	$ 224,033	$ 214,554	$ 199,325	$ 197,61	$ 193,563	$ 42,156	n/a
2011		165,657	182,587	187,479	191,025	183,797	179,046	179,286	44,792	n/a
2012			184,367	208,408	210,544	217,681	222,898	221,489	52,786	n/a
2013				167,161	182,201	188,179	205,580	200,550	66,333	n/a
2014					150,132	162,505	163,314	154,096	80,168	n/a
2015						136,660	136,287	145,517	80,124	n/a
2016							110,177	99,161	75,094	n/a
2017								101,006	94,525	n/a
								$ 1,294,668		

Cumulative Paid Claims and Loss Adjustment Expenses, Net of Reinsurance

Accident Year	Unaudited 2010	Unaudited 2011	Unaudited 2012	Unaudited 2013	Unaudited 2014	Unaudited 2015	Unaudited 2016	2017
2010	$ 2,625	$ 32,324	$ 59,108	$ 76,962	$ 98,850	$ 115,641	$ 128,06	$ 135,995
2011		8,439	26,950	48,852	70,623	92,391	104,049	116,525
2012			12,580	39,137	56,619	91,667	126,106	150,058
2013				7,719	21,710	59,074	79,649	96,647
2014					1,714	11,247	28,985	41,815
2015						1,364	12,956	32,014
2016							1,583	8,828
2017								1,248
								$ 583,130
All outstanding liabilities before 2010, net of reinsurance								$ 196,971
Liability for losses and loss expenses, net of reinsurance								$ 908,509

(Expressed in thousands of United States dollars, except share amounts)

Specialty

Incurred Claims and Loss Adjustment Expenses, Net of Reinsurance

Accident Year	Unaudited 2010	Unaudited 2011	Unaudited 2012	Unaudited 2013	Unaudited 2014	Unaudited 2015	Unaudited 2016	2017	As of December 31, 2017 Total IBNR	As of December 31, 2017 Cumulative Reported Claims
2010	$ 9,839	$ 7,533	$ 8,985	$ 8,730	$ 8,580	$ 8,977	$ 8,048	$ 7,954	$ 284	n/a
2011		28,414	25,548	20,498	21,403	22,958	20,521	20,031	1,181	n/a
2012			121,052	129,481	136,394	135,445	134,890	135,159	3,329	n/a
2013				109,987	104,738	99,336	101,074	100,180	2,355	n/a
2014					116,489	119,716	113,810	111,295	3,899	n/a
2015						124,331	122,406	118,446	8,582	n/a
2016							115,801	112,395	11,379	n/a
2017								134,225	119,567	n/a
								$ 739,685		

Cumulative Paid Claims and Loss Adjustment Expenses, Net of Reinsurance

Accident Year	Unaudited 2010	Unaudited 2011	Unaudited 2012	Unaudited 2013	Unaudited 2014	Unaudited 2015	Unaudited 2016	2017
2010	$ 2,075	$ 4,134	$ 6,130	$ 6,504	$ 6,969	$ 7,129	$ 7,341	$ 7,398
2011		3,140	12,290	15,482	16,644	17,599	18,134	18,205
2012			23,101	106,508	120,222	123,936	126,368	128,664
2013				3,202	75,059	91,151	92,426	95,432
2014					14,432	98,779	103,412	104,279
2015						4,031	91,384	105,524
2016							9,707	92,886
2017								7,885
								$ 560,723
All outstanding liabilities before 2010, net of reinsurance								$ 2,782
Liability for losses and loss expenses, net of reinsurance								$ 182,194

(Expressed in thousands of United States dollars, except share amounts)

d) Reconciliation of incurred and paid loss development triangles to the reserve for losses and loss expenses

The following table reconciles the net reserve for losses and loss expenses derived from the incurred and paid loss development triangles to the reserve for losses and loss expenses in the consolidated balance sheet as of December 31, 2017

			December 31, 2017
Net reserve for losses and loss expenses per the loss development triangles:			
Insurance:	Casualty	$	1,070,695
	Casualty - RSA acquired reserves		118,935
	Professional liability		1,394,747
	Property		207,331
	Property - RSA acquired reserves		40,940
	Programs		312,860
	Other specialty		257,449
	Other specialty - RSA acquired reserves		99,588
Reinsuranc	Property		285,144
	Casualty		908,509
	Specialty		182,194
Total net reserves for losses and loss expenses per the loss development triangles:		$	4,878,392
Reinsurance recoverable for each loss development triangle:			
Insurance:	Casualty	$	696,658
	Casualty - RSA acquired reserves		7,335
	Professional liability		668,955
	Property		251,389
	Property - RSA acquired reserves		10,338
	Programs		106,035
	Other specialty		132,666
	Other specialty - RSA acquired reserves		67,651
Reinsuranc	Property		51,254
	Casualty		—
	Specialty		5,863
Total reinsurance recoverables included in the loss development triangles:		$	1,998,144
Total gross reserves for losses and loss expenses included in the loss development triangles:		$	6,876,536
Other balances not included in the loss development triangles:			
	Unallocated loss adjustment expenses		128,819
	Other reserves not included in the loss development triangles		165,549
	Fair value adjustment		3,264
	Currency translation adjustment		(1,251)
	Other		(2,448)
			293,933
Total gross reserves for losses and loss expenses		$	7,170,469

e) Methods for estimating the reserve for losses and loss expenses, including IBNR reserves, and changes in methodologies

In general, the methods, and related assumptions, used for estimating the reserve for losses and loss expenses, including IBNR, are predicated on whether the line of business falls into one of the following two categories: short-tail line or long-tail line. In certain lines of business, claims are generally reported and paid within a relatively short period of time ("short-tail lines") during and following the policy coverage period. This generally enables the Company to determine with greater certainty the estimate of ultimate losses and loss expenses. The estimate of reserves for short-tail lines of business relies primarily on traditional loss reserving methodologies, utilizing selected paid and reported loss development factors, which are further explained below. Short-tail lines of business in the Insurance operation include general property, energy and inland marine, all of which are included in the 'property incurred and paid loss development triangle' and aviation, accident and health, and marine, which are included in the 'other specialty incurred and paid loss development triangle'. Short-tail lines of business in the Reinsurance operation include property reinsurance in the 'property incurred and paid loss development triangle', and crop and marine, which are included in the 'specialty incurred and paid loss development triangle'.

The casualty insurance and casualty reinsurance lines of business include general liability risks, healthcare, programs, professional liability and other specialty risks, such as environmental and construction risks. For most of the Company's lines of business, claims may be reported or settled several years after the coverage period has terminated ("long-tail lines"), which increases uncertainties of the reserve estimates in such lines. In addition, the attachment points for these long-tail lines can be relatively high, making reserving for these lines of business more difficult than short-tail lines due to having to estimate whether the severity of the estimated losses will exceed the attachment point. The Company establishes a case reserve when sufficient information is gathered to make a reasonable estimate of the liability, which often requires a significant amount of information and time. Due to the lengthy reporting pattern of these casualty lines, reliance is placed on industry benchmarks supplemented by the Company's own experience. For expected loss ratio selections, the Company considers its existing experience supplemented with analysis of loss trends, rate changes and experience of peer companies. Long-tail lines of business in the Insurance operation are included in the 'casualty incurred and paid loss development triangle', 'professional liability incurred and paid loss development triangle, 'programs incurred and paid loss development triangle', and 'other specialty incurred and paid loss development triangle'. Long-tail lines of business in the Reinsurance operation include casualty reinsurance in the 'casualty incurred and paid loss development triangle'.

In the Reinsurance operation, reinsurance contracts are reviewed individually, based upon individual characteristics and loss experience emergence. Loss reserves on assumed reinsurance often have unique features that make them more difficult to estimate than direct insurance. The Company establishes loss reserves upon receipt of advice from a cedent that a reserve is merited. The Company's claims staff may establish additional loss reserves where, in their judgment, the amount reported by a cedent is potentially inadequate. The following are the most significant features that make estimating loss reserves on assumed reinsurance difficult:

- Reinsurers rely upon the cedents and reinsurance intermediaries to report losses in a timely fashion.
- Reinsurers must rely upon cedents to price the underlying business appropriately.
- Reinsurers have less predictable loss emergence patterns than direct insurers, particularly when writing excess-of-loss reinsurance.

For excess-of-loss reinsurance, cedents generally are required to report losses that either exceed 50% of the retention, have a reasonable probability of exceeding the retention or meet serious injury reporting criteria. For quota share reinsurance treaties, cedents are required to give a periodic statement of account, generally monthly or quarterly. These periodic statements typically include information regarding written premiums, earned premiums, unearned premiums, ceding commissions, brokerage amounts, applicable taxes, paid losses and outstanding losses. They can be submitted 60 to 90 days after the close of the reporting period. Some quota share reinsurance treaties have specific language regarding earlier notice of serious claims.

Reinsurance generally has a greater time lag than direct insurance in the reporting of claims. The time lag is caused by the claim first being reported to the cedent, then the intermediary (such as a broker) and finally the reinsurer. This lag can be up to six months or longer in certain cases. There is also a time lag because the insurer may not be required to report claims to the reinsurer until certain reporting criteria are met. The Company uses reporting factors based on data from the Reinsurance Association of America to adjust for time lags. The Company also uses historical treaty-specific reporting factors when applicable. Loss and premium information are entered into the reinsurance system by the Company's claims and accounting departments on a timely basis.

The expected loss ratios that is assigned to each treaty are based upon analysis and modeling performed by a team of pricing actuaries. The historical data reviewed by the team of pricing actuaries is considered in setting the reserves for each cedent. The historical data in the submissions is matched against the carried reserves for the historical treaty years.

Loss reserves do not represent an exact calculation of liability. Rather, loss reserves are estimates of what the Company expects the ultimate resolution and administration of claims will cost. These estimates are based on actuarial and statistical projections and on an assessment of currently available data, as well as estimates of future trends in claims severity and frequency, judicial theories of liability and other factors. Loss reserve estimates are refined as experience develops and as claims are reported and resolved. In addition, the relatively long periods between when a loss occurs and when it may be reported to the Company's claims department for the casualty insurance and casualty reinsurance lines of business increase the uncertainties of our reserve estimates in such lines.

The Company utilizes a variety of standard actuarial methods in its analysis. The selections from these various methods are based on the loss development characteristics of the specific line of business. For lines of business with long reporting periods such as casualty reinsurance, the Company may rely more on an expected loss ratio method (as described below) until losses begin to develop. For lines of business with short reporting periods such as property insurance, the Company may rely more on a paid loss development method (as described below) as losses are reported relatively quickly. The actuarial methods utilized by the Company include:

Paid Loss Development Method. Ultimate losses are estimated by calculating past paid loss development factors and applying them to exposure periods with further expected paid loss development. The paid loss development method assumes that losses are paid at a consistent rate. The paid loss development method provides an objective test of reported loss projections because paid losses contain no reserve estimates. In some circumstances, paid losses for recent periods may be too varied for accurate predictions. For many coverages, especially casualty coverages, claim payments are made slowly and it may take years for claims to be fully reported and settled. These payments may be unreliable for determining future loss projections because of shifts in settlement patterns or because of large settlements in the early stages of development. Choosing an appropriate "tail factor" to determine the amount of payments from the latest development period to the ultimate development period may also require considerable judgment, especially for coverages that have long payment patterns. When necessary, the Company has had to supplement paid loss development patterns with appropriate benchmarks.

Reported Loss Development Method. Ultimate losses are estimated by calculating past reported loss development factors and applying them to exposure periods with further expected reported loss development. Since reported losses include payments and case reserves, changes in both of these amounts are incorporated in this method. This approach provides a larger volume of data to estimate ultimate losses than the paid loss development method. Thus, reported loss patterns may be less varied than paid loss patterns, especially for coverages that have historically been paid out over a long period of time but for which claims are reported relatively early and have case loss reserve estimates established. This method assumes that reserves have been established using consistent practices over the historical period that is reviewed. Changes in claims handling procedures, large claims or significant numbers of claims of an unusual nature may cause results to be too varied for accurate forecasting. Also, choosing an appropriate "tail factor" to determine the change in reported loss from the latest development period to the ultimate development period may require considerable judgment. When necessary, the Company has had to supplement reported loss development patterns with appropriate benchmarks.

Expected Loss Ratio Method. To estimate ultimate losses under the expected loss ratio method, earned premium is multiplied by an expected loss ratio. The expected loss ratio is selected utilizing industry data, historical company data and professional judgment. This method is particularly useful for new lines of business where there are no historical losses or where past loss experience is not credible.

Bornhuetter-Ferguson Paid Loss Method. The Bornhuetter-Ferguson paid loss method is a combination of the paid loss development method and the expected loss ratio method. The amount of losses yet to be paid is based upon the expected loss ratios and the expected percentage of losses unpaid. These expected loss ratios are modified to the extent paid losses to date differ from what would have been expected to have been paid based upon the selected paid loss development pattern. This method avoids some of the distortions that could result from a large development factor being applied to a small base of paid losses to calculate ultimate losses. This method will react slowly if actual loss ratios develop differently because of major changes in rate levels, retentions or deductibles, the forms and conditions of reinsurance coverage, the types of risks covered or a variety of other changes.

Bornhuetter-Ferguson Reported Loss Method. The Bornhuetter-Ferguson reported loss method is similar to the Bornhuetter-Ferguson paid loss method with the exception that it uses reported losses and reported loss development factors.

During 2017 and 2016, the Company adjusted its reliance on actuarial methods utilized for certain casualty lines of business and accident or treaty years within each of the operations shifting from the expected loss ratio method to the Bornhuetter-Ferguson reported loss method to varying degrees depending on the class of business, for example excess casualty versus primary casualty, and how old the accident or treaty year is. Placing greater reliance on more responsive actuarial methods for certain casualty lines of business and accident or treaty years within each of the Company's operations is a natural progression that allows further refinement to the estimate of the reserve for losses and loss expenses. The Company believes utilizing only the Bornhuetter-Ferguson reported loss method for certain older accident and treaty years will more accurately reflect the reported loss activity thus far in our ultimate loss ratio selections, and will better reflect how the ultimate losses will develop over time. The Company will continue to utilize the expected loss ratio method for the most recent accident and treaty years until we have sufficient experience to utilize other acceptable actuarial methodologies.

(Expressed in thousands of United States dollars, except share amounts)

We will continue to evaluate and monitor the development of these losses and the impact it has on our current and future assumptions. We believe recognition of the reserve changes in the period they were recorded was appropriate since a pattern of reported losses had not emerged and the loss years were previously too immature to deviate from the expected loss ratio method in prior periods.

f) Average historical claims duration

The following is unaudited supplementary information about average historical claims duration for lines of business within each operation as of December 31, 2017, except for the average historical claims duration related to the reserve for losses and loss expenses acquired from RSA. It is impractical to provide the average historical claims duration information for the RSA acquisition, as the Company does not have sufficient information at this disaggregated level. Providing the average historical claims duration for the acquired RSA reserves for losses and loss expenses since acquisition does not provide meaningful information regarding the trends and uncertainties of this business as there is not sufficient historical information, and as such it has not been provided in the table below. The tables below present the average annual payout of incurred claims by age, net of reinsurance. This information provides an estimate of the average length of time it takes for losses to be incurred. As discussed above, short-tail lines will have average historical claim durations that occur over the first several years, whereas long-tail lines will have claim durations that extend over many years. The averages calculated below are simple averages based on the ratio of net paid losses in a given accident year to the most recent incurred losses for that same accident year. As such, the averages noted below may overstate or understate the actual claims duration. For example, smaller lines of business that recently started writing insurance policies could have abnormally high average claim duration percentages compared to more mature lines of business.

Years	1	2	3	4	5	6	7	8
Insurance								
Casualty	3%	12%	17%	15%	14%	10 %	9%	6%
Professional liability	4%	16%	18%	16%	12%	10 %	7%	3%
Property	34%	41%	15%	6%	1%	1 %	—%	—%
Programs	10%	21%	20%	15%	12%	6 %	4%	2%
Other specialty	12%	25%	17%	9%	4%	2 %	29%	2%
Reinsurance								
Property	37%	37%	16%	6%	4%	2 %	1%	—%
Casualty	3%	9%	13%	11%	12%	9 %	7%	4%
Specialty	12%	61%	14%	3%	4%	2 %	2%	1%

7. CEDED REINSURANCE

The Company purchases reinsurance from third-party reinsurance companies to reduce its net exposure to losses. Reinsurance provides for recovery of a portion of gross losses and loss expenses from these reinsurers. The Company remains liable to the extent that its reinsurers do not meet their obligations under the related reinsurance contracts. The Company therefore regularly evaluates the financial condition of its reinsurers and monitors concentration of credit risk. The Company believes that as of December 31, 2017 its reinsurers are able to meet, and will meet, all of their obligations under the agreements. The provision for unrecoverable reinsurance was $623 and $1,225 as of December 31, 2017 and 2016, respectively. The amount of reinsurance recoverable is as follows:

(Expressed in thousands of United States dollars, except share amounts)

	2017	2016
OSLR recoverable	$ 468,758	$ 365,985
IBNR recoverable	1,582,183	1,184,474
Reinsurance recoverable	$ 2,050,941	$ 1,550,459
Reinsurance recoverable on paid losses	$ 169,192	$ 99,001

Direct, assumed and ceded premiums written and earned and losses and loss expenses incurred are as follows:

	Premiums Written	Premiums Earned	Losses and Loss Expenses
Year Ended December 31, 2017			
Direct	$ 2,171,223	$ 2,151,073	$ 2,114,314
Assumed	641,138	620,017	648,899
Ceded	(791,297)	(752,313)	(932,275)
	$ 2,021,064	$ 2,018,777	$ 1,830,938
Year Ended December 31, 2016			
Direct	$ 2,190,926	$ 2,155,442	$ 1,402,102
Assumed	623,026	642,178	323,833
Ceded	(756,574)	(671,086)	(386,123)
	$ 2,057,378	$ 2,126,534	$ 1,339,812
Year Ended December 31, 2015			
Direct	$ 2,121,747	$ 2,108,286	$ 1,387,925
Assumed	675,299	787,080	379,823
Ceded	(597,220)	(593,634)	(308,346)
	$ 2,199,826	$ 2,301,732	$ 1,459,402

Of the premiums ceded during the years ended December 31, 2017, 2016 and 2015, approximately 48%, 45% and 42%, respectively, were ceded to four reinsurers.

The Company actively manages its reinsurance exposures by generally selecting reinsurers having a credit rating of A- or higher and monitoring the overall credit quality of its reinsurers to ensure the recoverables will be collected. Approximately 97% and 99% of ceded reserves were recoverable from reinsurers who had an A.M. Best rating of “A” or higher as of December 31, 2017 and 2016, respectively.

8. FUNDS HELD

The Company has entered into a collateralized property catastrophe quota share reinsurance contract with Aeolus Re Ltd., a Bermuda-based property catastrophe reinsurer (“Aeolus Re”), whereby the Company assumes property catastrophe business underwritten by Aeolus Re. The Company provided a multi-year capital commitment to support the business being underwritten by Aeolus Re. To the extent that capital is not utilized to support the business being underwritten by Aeolus Re, as all obligations have been settled, the capital is returned to the Company. To the extent the losses are in excess of the premiums written, the capital is utilized to pay the claims. The capital commitment is recorded in "funds held" on the consolidated balance sheets. The funds held balance as of December 31, 2017 and 2016 was $407,600 and $442,000, respectively. For the years ended December 31, 2017, 2016 and 2015, the premiums written assumed by the Company through the collateralized property catastrophe quota share reinsurance contract with Aeolus Re were $35,100, $38,200 and $76,300, respectively.

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(Expressed in thousands of United States dollars, except share amounts)

9. DEBT AND FINANCING ARRANGEMENTS

a) Financing Structure

The following table shows the Company's financing structure:

	Outstanding[(1)]	Unamortized discount and debt issuance costs	Balance[(2)]
December 31, 2017			
External surplus note due 2037	22,500	—	22,500
$900,000 Secured letter of credit facility — uncommitted	389,800	—	—
	$ 412,300	$ —	$ 22,500

	Outstanding[(1)]	Unamortized discount and debt issuance costs	Balance[(2)]
December 31, 2016			
$900,000 Secured letter of credit facility — uncommitted	458,000	—	—
	$ 458,000	$ —	$ —

(1) Indicates utilization of commitment amount, not drawn borrowings.

(2) Represents the principal amount borrowed, net of unamortized discount and debt issuance costs.

b) External Surplus Note Due 2037

In 2017, the Company issued a senior surplus note for $22,500 with a floating interest rate equal to the applicable three-month U.S. Dollar LIBOR plus 7.0% effective interest per annum, in order to fund the formation of the reciprocal insurance entity (see note 2). Following the seventh anniversary of the issue date, the effective interest rate shall increase one percentage point each year not to exceed 12.0%. The interest payments are payable semi-annually and shall be made only after prior written approval is obtained from the Florida Office of Insurance Regulation. The outstanding balance of the note is included in "other long-term debt" on the consolidated balance sheet.

c) Credit Facilities

In the normal course of its operations, the Company enters into agreements with financial institutions to obtain secured and unsecured credit facilities.

The Company has a collateralized amended letter of credit facility with Citibank Europe plc. that has been and will continue to be used to issue standby letters of credit. The maximum aggregate amount available under this letter of credit facility as of December 31, 2017 and 2016 was $900,000 and $900,000, respectively on an uncommitted basis.

On November 27, 2007, Allied World Bermuda entered into an $800,000 five-year senior credit facility (the "Credit Facility") with a syndication of lenders. The Credit Facility consisted of a $400,000 secured letter of credit facility for the issuance of standby letters of credit (the "Secured Facility") and a $400,000 unsecured facility for the making of revolving loans and for the issuance of standby letters of credit.

On June 7, 2012, Allied World Bermuda amended the Secured Facility. The amended $450,000 four-year secured credit facility (the "Amended Secured Credit Facility") was to be primarily used for the issuance of standby letters of credit to support obligations in connection with the insurance and reinsurance business of Allied World Bermuda and its subsidiaries. A portion of the facility may have also been used for revolving loans for general corporate and working capital purposes, up to a maximum of $150,000. Allied World Bermuda may have requested that existing lenders under the Amended Secured Credit Facility make additional commitments from time to time, up to $150,000, subject to approval by the lenders. The Amended Secured Credit Facility contained representations, warranties and covenants customary for similar bank loan facilities, including certain covenants that, among other things, require the Company to maintain a certain leverage ratio and financial strength rating.

(Expressed in thousands of United States dollars, except share amounts)

On November 12, 2014, Allied World Bermuda gave irrevocable notice to the administrative agent under the Amended Secured Credit Facility to reduce the aggregate commitment from $450,000 to $150,000. All other material items of the Amended Secured Credit Facility remain unchanged.

On June 16, 2016, Allied World Bermuda entered into a Credit Agreement that provided for a $200,000 five-year senior unsecured revolving credit facility (the “Facility”) for the making of revolving loans and short-term swingline loans to the Company. The aggregate commitment of $200,000 under the Facility may have been increased by up to $150,000 upon the Company's request and upon the agreement of one or more Lenders or additional lenders. Borrowings in the form of swingline loans were subject to a sublimit of $25,000 included within the $200,000 aggregate commitment. Borrowings under the Credit Agreement may have been used by the Company for general corporate purposes. Borrowings under the Credit Agreement bore interest at a rate selected by the Company and equal to either the Base Rate or LIBOR plus a margin, other than swingline loans, which will have only bore interest at the Base Rate plus a margin. The Credit Agreement required that all revolving loans be repaid in full no later than the fifth anniversary of the Closing Date and that any swingline loans be repaid in full no later than the earlier of (i) ten business days after such swingline loan is made and (ii) the fifth anniversary of the Closing Date. The Company has unconditionally guaranteed the obligations under the Facility.

The Company paid customary arrangement and administration fees under the Credit Agreement. There was an additional fee payable at an annual rate based upon the long-term senior unsecured debt ratings of Allied World Switzerland and the Company in effect from time to time on the average daily unutilized commitments of the Lenders.

This Facility replaced the four-year senior secured credit facility under the Amended Secured Credit Facility, dated as of June 7, 2012, by and among the Company, the lenders party thereto, Citibank, N.A., as syndication agent, and Wells Fargo Bank, National Association, as administrative agent, fronting bank and letters of credit agent.

The facility entered into on June 16, 2016 was terminated effective July 11, 2017.

d) Debt Maturities

The following table reflects the Company’s debt maturities, which includes its other long-term debt:

	Amount
2018	$ —
2019	—
2020	—
2021	—
2022	—
2023 and thereafter	22,500
Total	$ 22,500

(Expressed in thousands of United States dollars, except share amounts)

10. GOODWILL AND INTANGIBLE ASSETS

The following table shows the Company's goodwill and intangible assets at December 31, 2017:

	Goodwill	Indefinite-Lived Intangible Assets	Finite-Lived Intangible Assets		
	Net Carrying Value	Net Carrying Value	Gross Carrying Value	Accumulated Amortization	Net Carrying Value
Balance at January 1, 2017	389,693	$ 23,920	$ 117,917	$ (37,092)	$ 80,825
Amortization of intangible assets	—	—	—	(9,280)	(9,280)
Foreign currency translation adjustment	263	—	3,255	—	3,255
Balance at December 31, 2017	$ 389,956	$ 23,920	$ 121,172	$ (46,372)	$ 74,800

As of December 31, 2017, goodwill of $386,100 and $3,900 was allocated to the Insurance operation and Reinsurance operation, respectively. The impairment reviews for goodwill and indefinite-lived intangibles did not result in the recognition of impairment losses for the years ended December 31, 2017 and 2016. The net carrying value of the goodwill is net of accumulated impairment charges of $200 that occurred prior to December 31, 2016.

As of December 31, 2017, the net carrying value of the finite-lived intangible assets is net of accumulated impairment charges of $9,100. As of December 31, 2017, the net carrying value of the finite-lived intangible assets is comprised of distribution network intangible assets of $70,200 and customer renewal intangible assets of $4,600. As of December 31, 2016, the net carrying value of the finite-lived intangible assets was comprised of distribution network intangible assets of $73,800 and customer renewal intangible assets of $7,100.

The estimated amortization expense for each of the five succeeding fiscal years and thereafter related to the Company’s finite-lived intangible assets is as follows:

	Amount
2018	$ 9,280
2019	7,667
2020	6,470
2021	6,250
2022	6,250
2023 and thereafter	38,883
Total	$ 74,800

11. INCOME TAXES

Under current Bermuda law, Allied World Bermuda and its Bermuda subsidiaries are not required to pay taxes in Bermuda on either income or capital gains. Allied World Bermuda and Allied World have received an assurance from the Bermuda Minister of Finance under the Exempted Undertakings Tax Protection Act 1966 of Bermuda, that in the event of any such taxes being imposed, Allied World Bermuda and Allied World will be exempted until March 2035.

(Expressed in thousands of United States dollars, except share amounts)

Certain subsidiaries of Allied World Switzerland file U.S. federal income tax returns and various U.S. state income tax returns, as well as income tax returns in Canada, Hong Kong, Ireland, Singapore, Switzerland and the United Kingdom. The Company has open tax years that are potentially subject to examinations by local tax authorities, in the following major tax jurisdictions: the U.S., 2011 to 2017; the United Kingdom, 2016 and 2017; Ireland, 2013 to 2017; Switzerland, 2015 to 2017; Hong Kong, 2011 to 2017; and Singapore, 2013 to 2017. During the year ended December 31, 2017, the U.S. Internal Revenue Service completed its audit of the 2014 tax return of the U.S. services company. There were no findings as a result of the audit. To the best of the Company's knowledge, there are no other income tax examinations pending by any other tax authority.

Management has deemed all material tax positions to have a greater than 50% likelihood of being sustained based on technical merits if challenged. The Company does not expect any material unrecognized tax benefits within 12 months of December 31, 2017.

The components of income tax expense are as follows:

	Year Ended December 31,		
	2017	2016	2015
Current income tax (benefit) expense	$ (13,271)	$ 4,571	$ 7,778
Deferred income tax expense (benefit)	6,450	(16,490)	(5,417)
Income tax (benefit) expense	$ (6,821)	$ (11,919)	$ 2,361

Deferred income taxes reflect the tax impact of temporary differences between the carrying amounts of assets and liabilities for financial reporting and income tax purposes, and are stated at the various enacted jurisdictional tax rates expected to be in effect when the reported amounts are recovered or settled. The significant components of the net deferred tax assets are as follows:

	December 31,	
	2017	2016
Deferred tax assets:		
Reserve for losses and loss expenses	$ 12,911	$ 21,411
Equity compensation	2,828	16,148
Unearned premium	10,242	17,047
Deferred acquisition costs	11,358	12,170
Mark-to-market losses	—	8,593
Tax credits	1,213	—
Net loss carryforward	40,995	7,245
Other	10,765	3,115
Total deferred tax assets	90,312	85,729
Deferred tax liabilities:		
Intangible assets	(14,831)	(21,857)
Depreciation	(2,041)	(4,406)
Market discount on bonds	—	(1,973)
Other	(570)	(4,230)
Total deferred tax liabilities	(17,442)	(32,466)
Valuation allowance	(36,395)	(10,315)
Net deferred tax assets	$ 36,475	$ 42,948

The valuation allowance reported in the current period relates to net operating loss carryforwards for the European and Asia Pacific operations as it is unlikely those operations will have sufficient income to utilize the net loss carryforwards in the near term. The valuation allowance increased by $26,080 during the year ended December 31, 2017 compared to the year ended December 31, 2016. The increase in the valuation allowance was due to the increase in the net loss carryforwards, which was caused by the significant catastrophe-related losses the Company incurred during the current year. The net loss carryforwards from the Asia Pacific operations do not expire. The net loss carryforward in our Swiss operations expire in seven years.

(Expressed in thousands of United States dollars, except share amounts)

As a result of the U.S. tax reform that was enacted into law on December 22, 2017, the Company adjusted the deferred tax assets and liabilities in the U.S. operations to reflect the change in the corporate tax rate from 35% to 21%. This resulted in a decrease in the net deferred tax assets of $30,357, which was recorded in income tax benefit in the consolidated income statement during the year ended December 31, 2017.

Current tax receivable and payable has been included in "other assets" and "accounts payable and accrued liabilities" on the consolidated balance sheets, respectively. Current taxes receivable or payable was as follows:

	December 31,	
	2017	2016
Current tax receivable	$ 10,864	$ 2,658
Current tax payable	$ 184	$ 652

The expected tax provision has been calculated using the pre-tax accounting income in each jurisdiction multiplied by that jurisdiction's applicable statutory tax rate. The statutory tax rates for our Bermuda, U.S.(for tax years 2017 and prior), Canada, Hong Kong, Ireland, Singapore, and the United Kingdom operations are 0%, 35%, 15%, 16.5%, 12.5%, 17% and 20%, respectively. The reconciliation between the Company's effective tax rate on pre-tax accounting income and the expected tax rate is as follows:

	Year Ended December 31,		
	2017	2016	2015
Expected tax rate	0.0%	0.0%	0.0%
Income not subject to income tax	0.0%	0.0%	0.3%
Valuation allowance	9.6%	1.8%	3.0%
Foreign taxes at local expected tax rates	(11.7%)	(4.8%)	(2.0%)
Impact of U.S. Tax reform	11.2%	—	—
Excess tax benefit	(6.1%)	0.3%	1.3%
Prior year refunds and adjustments	(0.3%)	(0.1%)	0.0%
Other	(0.2%)	(1.1%)	(1.4%)
Effective tax rate	2.5%	(3.9%)	1.2%

12. SHAREHOLDER'S EQUITY

a) Authorized shares

The authorized share capital of the Company as at December 31, 2017 and 2016 was $1,000. The issued share capital consists of the following:

	December 31,	
	2017	2016
Common shares issued and fully paid, par value $1 per share	1,000,000	1,000,000
Share capital at end of year	$ 1,000	$ 1,000

b) Dividends

Dividends declared on common stock were $497,000, $479,000 and $476,000 for the years ended December 31, 2017, 2016 and 2015, respectively.

c) Capital contributions and returns

In October 2015, Allied World Bermuda provided a capital contribution to the Company of $497,000. Subsequently, in April 2016 the Company returned capital to Allied World Bermuda of $250,000.

(Expressed in thousands of United States dollars, except share amounts)

13. EMPLOYEE BENEFIT PLANS

Allied World Switzerland implemented the Allied World Assurance Company Holdings, AG 2012 Omnibus Incentive Compensation Plan (the "2012 Omnibus Plan"). Under the 2012 Omnibus Plan, up to 4,500,000 common shares could have been issued, subject to adjustment. The 2012 Omnibus Plan provided for the grant of options intended to qualify as incentive stock options under the Internal Revenue Code, non-qualified stock options, stock appreciation rights, restricted shares, RSUs, deferred share units, cash incentive awards, performance-based compensation awards and other equity-based and equity-related awards. These awards generally vested pro rata over four years from the date of grant, except for the performance-based awards that generally vested over a three-year period based on the achievement of certain performance conditions. The 2012 Omnibus Plan was terminated once the Company was acquired by Fairfax. As a result of the acquisition of the Company by Fairfax, all unvested restricted stock units and performance-based awards were vested and settled in cash with each employee. As a result, the Company recorded additional compensation expense for the accelerated vesting of $23,626 for the restricted stock units and performance-based awards, and an additional $16,365 for the cash-equivalent restricted stock units and cash-equivalent performance-based awards.

The Company now participates in the Fairfax Financial Restricted Share Plan, which generally provides officers, key employees and directors who were employed by or provided services to the Company with awards of restricted shares of Fairfax common stock. The restricted share awards generally vest over five years. The Company had 46,434 restricted share awards granted and outstanding as of December 31, 2017 with a grant date fair value of $430.71 per share. The Company recorded compensation expense of $2,293 during the year ended December 31, 2017 for these awards. The remaining vesting period for these awards is 4.9 years as of December 31, 2017.

a) Employee option plan

Options under the 2012 Omnibus Plan were exercisable in certain limited conditions, expired after 10 years, and generally vested pro-rata over four years from the date of grant. The exercise price of options issued were approved by the Compensation Committee but were not less than the fair market value of the common shares of Allied World Switzerland on the date the option award was granted. Allied World Switzerland has not granted stock options since 2011.
The activity related to the Company's stock options is as follows:

	Year Ended December 31, 2017			
	Options	**Weighted Average Exercise Price**	**Weighted Average Contractual Term**	**Aggregate Intrinsic Value**
Outstanding at beginning of year	1,371,059	$ 17.41		
Exercised	(1,361,884)	(17.38)		
Forfeited	(9,175)	(14.50)		
Outstanding at end of year	—	—	—	$ —
Exercisable at end of year	—	$ —	—	$ —

As of December 31, 2017 and 2016, there was no remaining unrecognized compensation expense related to stock options granted under the Plan. As a result of the acquisition of the Company by Fairfax, all 1,165,770 outstanding options as of the date of the acquisition were settled in cash for $41,216.

b) Restricted stock units and performance-based equity awards

The RSUs vested pro-rata over four years from the date of grant. The compensation expense for the RSUs is based on the fair market value of Allied World Switzerland's common shares at the date of grant. The Company estimated the expected forfeitures of RSUs at the date of grant and recognized compensation expense only for those awards that the Company expected to vest. The forfeiture assumption was ultimately adjusted to the actual forfeiture rate.

Each award for the performance-based RSUs represented the right to receive a number of shares in the future, based upon the achievement of established performance criteria during the applicable performance period. The compensation expense for the performance-based RSUs was based on the fair market value of Allied World Switzerland's common shares at the time of grant. The expense was recognized over the performance period.

(Expressed in thousands of United States dollars, except share amounts)

The activity related to the Company's RSU awards is as follows:

	Year Ended December 31, 2017		
	Number of Awards	Weighted Average Grant Date Fair Value	Aggregate Intrinsic Value
Outstanding at beginning of year	985,426	$ 34.61	
RSUs forfeited	(20,114)	(34.79)	
RSUs fully vested	(965,312)	(34.56)	
Outstanding at end of year	—	$ —	$ —

As a result of the acquisition of the Company by Fairfax, all 658,810 outstanding restricted stock units as of the date of the acquisition were settled in cash for $34,798.

The activity related to the Company's performance-based equity awards is as follows:

	Year Ended December 31, 2017		
	Number of Awards	Weighted Average Grant Date Fair Value	Aggregate Intrinsic Value
Outstanding at beginning of year	538,572	$ 35.55	
Performance-based equity awards forfeited	(85,708)	(33.56)	
Performance-based equity awards fully vested	(452,864)	(35.92)	
Outstanding at end of year	—	$ —	$ —

As a result of the acquisition of the Company by Fairfax, all 391,146 outstanding performance-based equity awards as of the date of the acquisition were settled in cash for $20,660.

c) Cash-equivalent stock awards

As part of the Company's annual year-end compensation awards, the Company had granted both stock-based awards and cash-equivalent stock awards. The cash-equivalent awards were granted to employees who received RSU and performance-based awards and were granted in lieu of granting the full award as a stock-based award. The cash-equivalent RSU awards vested pro-rata over four years from the date of grant. The cash-equivalent performance-based awards vested after a three-year performance period. As the cash-equivalent awards were settled in cash, the Company established a liability equal to the product of the fair market value of Allied World Switzerland's common shares as of the end of the reporting period and the total awards outstanding. As a result of the acquisition of the Company by Fairfax all unvested restricted stock units and performance-based awards were vested and settled in cash with each employee.

(Expressed in thousands of United States dollars, except share amounts)

The activity related to the Company's cash-equivalent RSUs and performance-based equity awards is as follows:

	RSU's		Performance-based Awards	
Year Ended December 31, 2017	Number of Awards	Weighted Average Grant Date Fair Value	Number of Awards	Weighted Average Grant Date Fair Value
Outstanding at beginning of year	689,689	$ 33.81	404,530	$ 35.64
Forfeited	(10,208)	(35.74)	(128,566)	(33.56)
Fully vested	(679,481)	(33.86)	(275,961)	(37.42)
Outstanding at end of year	—	$ —	—	$ —

As a result of the acquisition of the Company by Fairfax, all 483,214 outstanding cash equivalent restricted stock units and cash equivalent performance-based equity awards as of the date of the acquisition were settled in cash for $25,523.

d) Total Stock Related Compensation Expense

The following table shows the total stock related compensation expense relating to the stock options, RSUs and performance-based equity awards, and cash equivalent awards.

	Year Ended December 31,		
	2017	2016	2015
Stock options	$ —	$ —	$ 273
RSUs and performance-based equity awards	7,375	14,167	13,269
Cash-equivalent stock awards	16,720	20,082	31,349
Total	$ 24,095	$ 34,249	$ 44,891

e) Pension Plans

The Company provides defined contribution retirement plans for its employees and officers. Contributions are made by the Company, and in some locations, these contributions are supplemented by the local plan participants. Contributions are based on a percentage of the participant’s base salary depending upon competitive local market practice and vesting provisions meeting legal compliance standards. The amount that an individual employee or officer can contribute may also be subject to regulatory requirements relating to the country of which the individual is a citizen. The Company incurred expenses for these defined contribution arrangements of $11,787, $11,820 and $11,374 for the years ended December 31, 2017, 2016 and 2015, respectively.

f) Employee Share Purchase Plan

Under the Allied World Assurance Company Holdings, AG Amended and Restated 2008 Employee Share Purchase Plan (“ESPP”), eligible employees of the Company were offered the opportunity to purchase common shares of the Company at a 15% discount from the fair market value of one common share on the last trading day of each offering period. Employees purchased a variable number of common shares through payroll deductions elected as of the beginning of the offering period. The Company could have sold up to 3,000,000 common shares to eligible employees under the ESPP. This plan was canceled in connection with the acquisition of the Company by Fairfax.

(Expressed in thousands of United States dollars, except share amounts)

14. COMMITMENTS AND CONTINGENCIES

a) Concentrations of Credit Risk

Credit risk arises out of the failure of a counterparty to perform according to the terms of the contract.

The Company's investment portfolio is managed pursuant to guidelines that follow prudent standards of diversification. The guidelines limit the allowable holdings of a single issue and issuers. The Company believes that there are no significant concentrations of credit risk associated with its investment portfolio. As of December 31, 2017 and 2016, substantially all of the Company's cash and investments were held with one custodian.

Insurance balances receivable primarily consist of net premiums due from insureds and reinsureds. The Company believes that the counterparties to these receivables are able to meet, and will meet, all of their obligations. The Company's credit risk is further reduced by the contractual right to offset loss obligations or unearned premiums against premiums receivable The insurance balances receivable that are outstanding greater than 90 days was $15,923 as of December 31, 2017, which represented 2.1% of the total receivable balance. Given the trend of writing more retail business, the Company has recorded an allowance for doubtful accounts against insurance balances receivable of $2,496 as of December 31, 2017.

b) Operating Leases

The Company leases office space under operating leases expiring in various years through 2031. The following are future minimum rental payments as of December 31, 2017:

	Amount
2018	$ 21,646
2019	20,662
2020	18,607
2021	17,528
2022	15,622
2023 and thereafter	99,268
	$ 193,333

Total rent expense for the years ended December 31, 2017, 2016 and 2015 was $19,908, $18,267 and $22,874, respectively. The rent expense for the years ended December 31, 2017, 2016 and 2015 is net of sublease income of $1,380, $1,020 and $681, respectively.

c) Producers

The three largest individual producers as a percentage of gross premiums written are as follows:

	Year Ended December 31,		
	2017	2016	2015
Marsh & McLennan Companies, Inc.	20%	21%	22%
Aon Corporation	13%	12%	13%
Willis Group Holdings	9%	8%	9%
Total	42%	41%	44%

d) Legal Proceedings

The Company, in common with the insurance industry in general, is subject to litigation and arbitration in the normal course of its business. These legal proceedings generally relate to claims asserted by or against the Company in the ordinary course of insurance or reinsurance operations. Estimated amounts payable under these proceedings are included in the reserve for losses and loss expenses in the Company's consolidated balance sheets. As of December 31, 2017, the Company was not a party to any material legal proceedings arising outside the ordinary course of business that management believes will have a material adverse effect on the Company's results of operations, financial position or cash flow.

(Expressed in thousands of United States dollars, except share amounts)

e) Guarantee

In August 2011, the Company agreed to guarantee all of the insurance and reinsurance contracts of Allied World AG, where such obligations have become due and payable in accordance with their terms. The guarantee has been provided so that Allied World AG may obtain financial strength ratings similar to that of the Company.

This guarantee shall terminate after twelve months written notice to Standard & Poor's ("S&P"), with a copy of such notice published in a national newspaper in Switzerland nominated by the Guarantor, of a) the date in which all of the guaranteed obligations are paid in full or b) the date on which the Primary Obligor obtains A+ or higher insurer financial strength ratings from S&P without the assistance of the guarantee.

15. LOANS TO AFFILIATES

On November 29, 2012, the Company issued a promissory note to Allied World Financial Services, Ltd, a subsidiary of Allied World Bermuda. The principal sum of the note amount was $83,200 with an interest rate of 4.2% per annum. Commencing June 30, 2015, all unpaid accrued interest due and payable shall be paid in full on each June 30, and the principal and all unpaid accrued interest shall be due and payable in full on November 29, 2022. The principal and accrued interest balance due to the Company was settled in full during 2017 at the outstanding balance of $40,173.

16. STATUTORY CAPITAL AND SURPLUS

The minimum required statutory capital and surplus is the amount of statutory capital and surplus necessary to satisfy regulatory requirements based on the Company's current operations. The statutory capital and surplus and minimum required statutory capital and surplus for the Company's most significant regulatory jurisdictions at December 31, 2017 and 2016 were as follows:

	December 31, 2017		December 31, 2016	
	Statutory Capital and Surplus	Minimum Required Statutory Capital and Surplus	Statutory Capital and Surplus	Minimum Required Statutory Capital and Surplus
Bermuda	$ 2,741,054	$ 785,491	$ 3,494,142	$ 800,242
United States	1,165,349	310,455	1,185,934	263,303
Ireland	410,314	92,769	395,472	84,692

There were no state-prescribed or permitted regulatory accounting practices for any of our insurance entities that resulted in reported statutory surplus that differed from that which would have been reported under the prescribed practices of the respective regulatory authorities, including the National Association of Insurance Commissioners. Statutory accounting under the prescribed practices of the respective regulatory authorities differs from U.S. GAAP accounting in the treatment of various items, including reporting of investments, acquisition costs and deferred income taxes.

The statutory net income (loss) for the Company's most significant regulatory jurisdictions for the years ended December 31, 2017, 2016 and 2015 was as follows:

	Year Ended December 31,		
	2017	2016	2015
Bermuda	$ (213,973)	$ 366,412	$ 221,540
United States	(30,299)	19,047	40,546
Ireland	11,544	10,126	3,170

(Expressed in thousands of United States dollars, except share amounts)

At December 31, 2017, the maximum amount of ordinary dividends or distributions that can be paid, without prior regulatory approval, for the Company's most significant regulatory jurisdictions, were as follows:

		December 31, 2017
Bermuda	$	685,264
United States		1,837
Ireland		47,017

a) Bermuda

Allied World is registered under the Bermuda Insurance Act 1978 and Related Regulations as amended. As a Class 4 insurer, Allied World is required to maintain minimum solvency standards and to hold available statutory capital and surplus equal to or exceeding the enhanced capital requirements as determined by the Bermuda Monetary Authority under the Bermuda Solvency Capital Requirement model ("BSCR model"). The BSCR model is a risk-based capital model that provides a method for determining an insurer's minimum required capital taking into account the risk characteristics of different aspects of the company's business. In addition, this subsidiary is required to maintain a minimum liquidity ratio. As of December 31, 2017 and 2016, this subsidiary met the requirements.

b) United States

The Company's U.S. insurance subsidiaries are subject to the insurance laws and regulations of the states in which they are domiciled, and also states in which they are licensed or authorized to transact business. These laws also restrict the amount of ordinary shareholder dividends the subsidiaries can pay. The restrictions are generally based on statutory surplus and/or statutory net income as determined in accordance with the relevant statutory accounting requirements of the individual domiciliary states. The U.S. subsidiaries are required to file annual statements with insurance regulatory authorities prepared on an accounting basis prescribed or permitted by such authorities. The U.S. subsidiaries are also required to maintain minimum levels of solvency and liquidity as determined by law, and comply with capital requirements and licensing rules. As of December 31, 2017 and 2016, the actual levels of solvency, liquidity and capital of each U.S. subsidiary were in excess of the minimum levels required.

c) Ireland

The Company's Irish insurance subsidiary is regulated by the Central Bank of Ireland pursuant to the Insurance Acts 1909 to 2000, the Central Bank Acts 1942 to 2015 and all statutory instruments relating to insurance made or adopted under the European Communities Acts 1972 to 2014, including the European Union (Insurance and Reinsurance) Regulations, 2015. This subsidiary is required to maintain a minimum level of capital. As of December 31, 2017 and 2016, these requirements were met. The amount of dividends that this subsidiary is permitted to distribute is restricted to accumulated realized profits that have not been capitalized or distributed, less accumulated realized losses that have not been written off. The solvency and capital requirements must still be met following any distribution.

d) Branch Offices

The Company's insurance subsidiaries maintain branch offices in Australia, United Kingdom, Switzerland, Hong Kong, Canada, Singapore and Labuan. As branch offices are not considered separate legal entities, the required and actual statutory capital and surplus amounts for each jurisdiction in the table above include amounts related to the branch offices. These branch offices are subject to additional minimum capital or asset requirements in their countries of domicile. At December 31, 2017 and 2016, the actual capital and surplus for each of these branches exceeded the relevant local regulatory requirements.

17. RELATED PARTY TRANSACTIONS

The Company has entered into various assumed and ceded reinsurance contracts with several entities that are controlled by Fairfax. The following summarizes the balances and activity from the date of acquisition by Fairfax to December 31, 2017:

(Expressed in thousands of United States dollars, except share amounts)

	As of December 31, 2017 and for the period from July 6, 2017 to December 31, 2017
Balance Sheet:	
Reinsurance recoverables	$ 80,264
Prepaid reinsurance	11,300
Reinsurance recoverables on paid losses	3,826
Reserve for losses and loss expenses	12,100
Unearned premiums	100
Deferred ceding commission income	3,358
Reinsurance balances payable	3,600
Income Statement:	
Written ceded premiums	(9,256)
Earned ceded premiums	(11,979)
Assumed losses and loss expenses	(1,000)
Ceded losses and loss expenses	14,344
Ceding commission income earned	3,161

The Company's subsidiaries have entered into investment management agreements with Fairfax and its wholly-owned subsidiary, Hamblin Watsa Investment Counsel Ltd. These agreements generally provide for an annual base fee, calculated and paid quarterly based upon each subsidiary's average invested assets for the preceding three months, and an incentive fee, which is payable if realized gains on equity investments exceed certain benchmarks. These agreements may be terminated by either party on 30 days notice. During the year ended December 31, 2017, the Company incurred $6,000 in investment management fees, and were included as a reduction to net investment income in the consolidated financial statements.

The Company has Amounts due from affiliates of $203,820 and $91,798 and Amounts due to affiliates of $111,896 and $28,287 as at December 31, 2017 and 2016, respectively. The amounts relate to intercompany recharges, receivables and payables incurred in the normal course of business on behalf of other Allied World affiliated companies.

18. SUBSEQUENT EVENTS

The Company considers events or transactions that occur after the consolidated balance sheet date but before the consolidated financial statements are available to be issued to provide additional evidence relative to certain estimates or to identify matters that require additional disclosure. Subsequent events have been evaluated through April 27, 2018, the date that the consolidated financial statements were available to be issued.