TOKIO MARINE
T M R

Tokio Millennium Re

DELIVERING ON COMMITMENTS
BUILDING ON RELATIONSHIPS

2016 Annual Report

FINANCIAL HIGHLIGHTS

Rating	Agency
A++	A.M. BEST
A+	STANDARD & POOR'S

Item	Unit	Value
Total Assets	USD Million	4,433.3
Net Premium Written	USD Million	1,317.9
Net Assets	USD Million	1,320.8
Net Income	USD Million	120.7
Loss Ratio	Percent	58.6
Combined Ratio	Percent	95.8

MESSAGE FROM THE CEO

Delivering on our commitments to customers is a core value for TMR.

As we continue to build on the strengths of the long term strategy we have in place at Tokio Millennium Re (TMR), I am pleased to report a successful delivery on many fronts in 2016 despite challenging market conditions.

FURTHER STRENGTHENING OUR BALANCE SHEET

Our net income for 2016 was USD 120.7 million, which is an increase to our bottom line of 12% compared to 2015. The main drivers behind this strong performance were not only our consistent, analytical and prudent approach to underwriting and reserving, but also favorable investment income returns and our continued investment in our third party capital strategy. We applied this same rigor to our internal operations resulting in a slight decrease in our administrative expense ratio. Our results also benefited from favorable external factors with below average catastrophe losses and gains from foreign exchange.

A full analysis of our 2016 financials is set forth on the following pages.

OPTIMISATION OF OUR BUSINESS PORTFOLIO AND CONTINUED LARGE CAPACITY OFFERING TO CUSTOMERS

After several years of growing our portfolio, we successfully delivered on a plan to optimise rather than continuous growth given the current soft market conditions. Our priority now is to carefully manage the profitability of our book of business through robust and analytical risk selection, while simultaneously continuing our focus on risk diversification.

We successfully reduced portfolio volatility through proactive risk management and further deployment of our third party capital strategy. Our ability to offer large capacities to our customers remains a priority despite the current market conditions. We also deployed significant resources to support the launch of a technology platform for use with our capital markets partners, offering TMR and its partners the ability to more efficiently match ceded risk with capital.

MESSAGE FROM THE CEO

CONTINUED

Our ability to offer large capacities to our customers remains a priority despite the current market conditions.

SUCCESSFULLY OPTIMISING OUR OPERATIONAL PLATFORM TO BETTER SERVE OUR CUSTOMERS IN THE FUTURE

In order to meet the ever increasing demands for greater efficiency and responsiveness, we believe that an adaptable and efficient operating platform is a key to success. For this reason, in 2016 we completed a holistic review of our IT systems, processes and organisational set up, the result of which is a new operating platform which was introduced in early 2017. Our new operating platform ensures the agility to adapt to changing market conditions and customer needs, creates efficiency to provide high quality services to our customers and provides us the option of scalability so that we are better able to take advantage of future market opportunities.

OUR ULTIMATE SUCCESS IS DELIVERY ON OUR COMMITMENTS TO OUR STAKEHOLDERS

Delivering on our commitments to customers is a core value for TMR. Doing so not only helps our customers, but more broadly, together with our cedants, helps TMR play a vital role in bringing resilience to our societies in times of need. Alongside our efforts to optimise our business portfolio and stabilise our top line, we continue to offer innovative solutions to our customers backed by our strong financial strength and ratings.

The various successes in 2016 delivered favorable results for TMR this past year and have further strengthened TMR's future earnings potential. I am convinced that with our dedicated team of more than 180 employees, the strong support of the Tokio Marine Group and our analytical insights and approach to risk, TMR remains in a unique position to continue to deliver on all of its stakeholder commitments.

Stephan Ruoff
Chief Executive Officer

MESSAGE FROM THE CFO

The 2016 results reflect our careful underwriting approach, a successful investment strategy and disciplined cost management.

2016 was another profitable year for TMR. In challenging market conditions, we achieved a net income of USD 120.7 million for the year compared to USD 107.8 million in 2015. This resulted in a return on equity of 9.2% compared to 8.8% in 2015. Underwriting income benefited from a continuing disciplined underwriting approach and prudent reserving practice. In addition, our results benefited from strong contributions from investment income, foreign exchange gains and active cost control.

SOLID UNDERWRITING PERFORMANCE BASED ON DISCIPLINED UNDERWRITING

The overall underwriting performance remained solid in 2016, delivering a net underwriting income of USD 156.1 million. The decrease of 10.8% compared to 2015 stemmed primarily from higher cat loss activity this year compared to 2015.

The disciplined underwriting efforts were noticeable at the top line premium level. Gross written premium for 2016 remained stable at USD 1.5 billion. The combined ratio was 95.8%, benefiting from the relative absence of large natural catastrophe events in the year and net prior year reserve releases equating to 3.2 loss ratio points. We utilised some of these positive gains to bolster current year reserves, maintaining our prudent stance in that regard.

TMR RESULTS AIDED BY INVESTMENT RETURNS AND FOREIGN EXCHANGE GAINS

Our 2016 result was more positive thanks to an investment income return of USD 60.9 million, contributing 50% of our net income after tax, compared to USD 35.3 million in 2015. The investment income increased by 72% compared to prior year primarily due to increased investment leverage on our balance sheet and an increased allocation to higher yielding assets. TMR also recorded a foreign exchange gain of USD 15.1 million for the year, which enhanced the bottom line significantly. This was in large part due to the appreciation of USD against GBP following the UK's vote to leave the European Union.

MESSAGE FROM THE CFO

CONTINUED

TMR continues to be very well positioned to deliver long term, sustainable value for our shareholder, customers and employees.

COST CONTROL - A CONTINUED PRIORITY

With the establishment of our UK branch in the summer of 2015, the administrative expenses for the 2016 year reflected the full year costs of the new branch for the first time, resulting in slightly higher expenses of USD 108.6 million compared to USD 106.4 million for 2015. Nonetheless, TMR's continued efforts to reduce administrative expenses resulted in a 1.8% lower administrative expense ratio of 9.6% compared to 11.4% in 2015, thereby contributing to an enhanced net income.

STRONGER CONTRIBUTION FROM THIRD PARTY CAPITAL STRATEGY

Our third party capital strategy continues to enhance our bottom line as we work with select third party capital partners. The deployment of our bespoke advanced technology platform to trade with select partners has given us increased scale and flexibility to drive our third party capital strategy going forward.

TMR IS FINANCIALLY WELL POSITIONED TO CONTINUE TO DELIVER VALUE TO ALL OUR STAKEHOLDERS

Based on prudent capital management, TMR paid out a dividend to our shareholder amounting to USD 5.9 million in 2016. TMR's group capitalisation remains very strong with shareholder's equity of USD 1.3 billion going into 2017.

In summary, the 2016 results reflect our careful underwriting approach, a successful investment strategy and disciplined cost management. As a consequence, TMR continues to be very well positioned to deliver long term, sustainable value for our shareholder, customers and employees.

Maurice Kane
Chief Financial Officer

CORPORATE INFORMATION

TOKIO MILLENNIUM RE AG

DIRECTORS
(as at 31 December 2016)

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Richard Bennison
Hans-Peter Gerhardt
Stephan Ruoff
Misao Shinohara
Toshi Suzuki

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Tokio Millennium Re

FINANCIAL STATEMENTS

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors — Tokio Millennium Re AG

REPORT OF THE STATUTORY AUDITOR ON THE CONSOLIDATED FINANCIAL STATEMENTS

As statutory auditor, we have audited the accompanying consolidated financial statements of Tokio Millennium Re AG, which comprise the balance sheet, statement of comprehensive income, cash flow statement, statement of changes in equity and notes (pages 10 to 62), for the year ended 31 December 2016.

Board of Directors' Responsibilities

The Board of Directors is responsible for the preparation of the consolidated financial statements in accordance with the International Financial Reporting Standards (IFRS) and the requirements of Swiss law. This responsibility includes designing, implementing and maintaining an internal control system relevant to the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error. The Board of Directors is further responsible for selecting and applying appropriate accounting policies and making accounting estimates that are reasonable in the circumstances.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with Swiss law and Swiss Auditing Standards as well as the International Standards on Auditing. Those standards require that we plan and perform the audit to obtain reasonable assurance 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 the auditor's 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, the auditor considers the internal control system relevant to the entity's preparation 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 entity's internal control system. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made, 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, which comprise the balance sheet, statement of comprehensive income, cash flow statement, statement of changes in equity and notes for the year ended 31 December 2016 give a true and fair view in accordance with the International Financial Reporting Standards (IFRS) and comply with Swiss law.

Other Matter

The consolidated financial statements of Tokio Millennium Re AG for the year ended 31 December 2015 were audited by another firm of auditors whose report, dated 2 March 2016, expressed an unmodified opinion on those statements.

REPORT ON OTHER LEGAL REQUIREMENTS

We confirm that we meet the legal requirements on licensing according to the Auditor Oversight Act (AOA) and independence (article 728 CO and article 11 AOA) and that there are no circumstances incompatible with our independence.

In accordance with article 728a paragraph 1 item 3 CO and Swiss Auditing Standard 890, we confirm that an internal control system exists which has been designed for the preparation of consolidated financial statements according to the instructions of the Board of Directors.

We recommend that the consolidated financial statements submitted to you be approved.

PricewaterhouseCoopers AG

Ray Kunz

Audit Expert
Auditor in Charge

Philip Kirkpatrick

Audit Expert

Zürich, 14 March 2017

CONSOLIDATED BALANCE SHEET

31 December 2016 and 2015

USD '000	Notes	2016	2015
Assets			
Cash and cash equivalents	5	313,775	279,037
Funds withheld	6	71,768	78,996
Investments	7, 8	2,256,285	1,993,777
Accrued interest receivable	11	14,151	12,035
Premiums receivable	11	856,770	716,399
Deposit assets	11, 12	393,823	296,177
Prepaid reinsurance premiums		58,184	37,676
Fair value of derivative assets	8	3,960	4,773
Outstanding losses recoverable from reinsurers	11, 17	64,975	52,730
Deferred acquisition expenses	13	359,834	327,938
Unearned profit commission		2,764	6,071
Current tax asset		1,082	1,234
Deferred tax asset	14	2,183	3,021
Property and equipment	15	9,573	11,840
Intangible assets	16	9,162	8,429
Other assets	11	15,032	20,623
Total assets		**4,433,321**	**3,850,756**
Liabilities			
Outstanding losses and loss expenses	17, 18	1,114,659	857,700
Liability for collateral held on behalf of counterparties	10, 18	185,536	233,617
Reinsurance balances payable	18	93,162	89,107
Deposit liabilities	12, 18	393,823	296,177
Payable for investments purchased	18	7,947	8,748
Unearned premiums	17	1,237,051	1,083,347
Fair value of derivative liabilities	8, 18	4,008	4,307
Deferred commission income	13	6,065	3,511
Accounts payable and accrued expenses	18	35,966	36,565
Retirement benefit obligation	20	4,497	3,284
Deferred fee income		3,659	2,793
Current tax liability		1,062	–
Deferred tax liability	14	129	706
Note payable	18, 19	25,000	25,000
Total liabilities		**3,112,564**	**2,644,862**
Shareholder's equity			
Share capital	21	250,000	250,000
Contributed surplus	21	400,000	400,000
Retained earnings		715,127	600,349
Accumulated other comprehensive income		(44,370)	(44,455)
Total shareholder's equity		**1,320,757**	**1,205,894**
Total liabilities and shareholder's equity		**4,433,321**	**3,850,756**

See accompanying notes to consolidated financial statements

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

Years ended 31 December 2016 and 2015

USD '000	Notes	2016	2015
Revenue			
Reinsurance premiums assumed	4	1,552,640	1,546,288
Change in unearned premiums		(199,359)	(411,584)
Reinsurance premiums earned – assumed		1,353,281	1,134,704
Reinsurance premiums ceded	22	234,724	206,970
Change in prepaid reinsurance		(20,562)	(3,822)
Reinsurance premiums earned – ceded		214,162	203,148
Net premiums earned		1,139,119	931,556
Net derivative income	9	2,238	8,657
Other underwriting income		3,835	5,075
Foreign exchange gains		15,117	5,087
Total operating income		1,160,309	950,375
Net investment income	7	60,872	35,310
Total revenue		**1,221,181**	**985,685**
Expenses			
Loss and loss expenses incurred		697,037	509,514
Losses recoverable from reinsurers		(30,497)	(2,084)
Net loss and loss expenses incurred	17	666,540	507,430
Acquisition expenses	23	314,337	251,546
Profit commission		6,860	9,787
Other underwriting expenses		1,386	1,514
General and administrative expenses	24	108,616	106,358
Total expenses		**1,097,739**	**876,635**
Profit before tax		123,442	109,050
Tax expense	14	(2,770)	(1,238)
Profit		**120,672**	**107,812**

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME (continued)

Years ended 31 December 2016 and 2015

USD '000	2016	2015
Other comprehensive income (loss)		
Items that are or may be reclassified to profit or loss		
Net change in unrealised gains (losses) on investments	3,219	(23,562)
Net change in tax reserve for unrealised gains on investments	231	717
Change in foreign currency translation adjustment	(2,082)	(6,986)
	1,368	(29,831)
Item that will not be reclassified to profit or loss		
Change in retirement benefit obligation	(1,283)	(132)
Other comprehensive income (loss), net of tax	85	(29,963)
Total comprehensive income	**120,757**	**77,849**

See accompanying notes to consolidated financial statements

CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

Years ended 31 December 2016 and 2015

USD '000	**Share capital**	**Contributed surplus**	**Retained earnings**	Unrealised gain (loss) on investments	Tax reserve on unrealised investment gains	Foreign currency translation reserve	Retirement benefit obligation	**Accumulated other comprehensive income**	**Total**
Balance 1 January 2015	**250,000**	**400,000**	**563,807**	7,827	(948)	(18,884)	(2,487)	**(14,492)**	**1,199,315**
Profit	–	–	107,812	–	–	–	–	–	107,812
Other comprehensive income (loss)	–	–	–	(23,562)	717	(6,986)	(132)	(29,963)	(29,963)
Dividends	–	–	(71,270)	–	–	–	–	–	(71,270)
Balance 31 December 2015	**250,000**	**400,000**	**600,349**	(15,735)	(231)	(25,870)	(2,619)	**(44,455)**	**1,205,894**
Profit	–	–	120,672	–	–	–	–	–	120,672
Other comprehensive income (loss)	–	–	–	3,219	231	(2,082)	(1,283)	85	85
Dividends	–	–	(5,894)	–	–	–	–	–	(5,894)
Balance 31 December 2016	**250,000**	**400,000**	**715,127**	(12,516)	–	(27,952)	(3,902)	**(44,370)**	**1,320,757**

See accompanying notes to consolidated financial statements

CONSOLIDATED STATEMENT OF CASH FLOWS

Years ended 31 December 2016 and 2015

USD '000	Notes	2016	2015
Cash flows from operating activities			
Profit before tax		123,442	109,050
Adjustments for:			
Depreciation of property and equipment	15	2,707	3,997
Amortisation of intangible assets	16	4,978	4,059
Amortisation of investments		4,224	7,814
Interest income		(64,507)	(42,498)
Net realised gains on sale of investments	7	(4,732)	(2,864)
Net impairment and other investment losses		1,246	2,582
Net change in unrealised (gains) losses on other securities	7	(1,176)	167
Other non cash movements		(1,111)	7,148
Change in:			
Funds withheld		7,228	(26,195)
Premiums receivable		(140,371)	(241,816)
Deposit assets	12	(97,646)	41,500
Prepaid reinsurance premiums		(20,508)	(3,476)
Fair value of derivative assets		813	(2,967)
Outstanding losses recoverable from reinsurers		(12,245)	(1,257)
Deferred acquisition expenses		(31,896)	(126,410)
Unearned profit commission		3,307	(4,281)
Other assets		5,591	4,177
Outstanding losses and loss expenses		256,959	158,395
Liability for collateral held on behalf of counterparties		(48,081)	(81,633)
Reinsurance balances payable		4,055	36,084
Deposit liabilities	12	97,646	(41,500)
Unearned premiums		153,704	394,520
Fair value of derivative liabilities		(299)	1,757
Deferred commission income		2,554	671
Accounts payable and accrued expenses		679	18,584
Deferred fee income		866	(806)
Cash provided by operating activities		247,427	214,802
Income taxes paid		(1,168)	(1,073)
Net cash provided by operating activities		**246,259**	**213,729**

CONSOLIDATED STATEMENT OF CASH FLOWS (continued)

Years ended 31 December 2016 and 2015

USD '000	2016	2015
Cash flows from investing activities		
Interest received	62,391	38,062
Purchase of investments	(977,855)	(1,100,993)
Proceeds on sales and maturities of investments	711,357	1,036,079
Purchase of property and equipment	(441)	(2,068)
Purchase of intangible assets	(5,711)	(5,298)
Net cash used in investing activities	**(210,259)**	**(34,218)**
Cash flows from financing activities		
Interest paid	(1,278)	(1,267)
Dividends paid	(5,894)	(71,270)
Net cash used in financing activities	(7,172)	(72,537)
Net increase in cash and cash equivalents	28,828	106,974
Foreign exchange gains on cash and cash equivalents	5,910	4,303
Cash and cash equivalents at beginning of year	279,037	167,760
Cash and cash equivalents at end of year	**313,775**	**279,037**

See accompanying notes to consolidated financial statements

1. GENERAL

Tokio Millennium Re AG (the "Company" or "TMR AG"), formerly known as Tokio Millennium Re Ltd., is a Swiss based reinsurance company and is licensed and regulated by the Swiss Financial Market Supervisory Authority ("FINMA"). TMR AG's registered office is located at Beethovenstrasse 33, 8002 Zurich, Switzerland. The Company is a wholly owned subsidiary of Tokio Marine and Nichido Fire Insurance Co., Ltd. The ultimate parent company is Tokio Marine Holdings, Inc., a company incorporated in Japan.

The Company was formed in Bermuda on 15 March 2000 and redomesticated to Switzerland on 15 October 2013. TMR AG has become subject to Swiss law without liquidation and re establishment.

The Company participates in various excess of loss property catastrophe, workers' compensation catastrophe, crop/hail and terrorism reinsurance contracts. Catastrophe reinsurance covers unpredictable events such as hurricanes, windstorms, hailstorms, earthquakes, fires, freezes, floods and other man made or natural disasters. The Company also offers non catastrophe property and casualty covers on both proportional and per risk excess of loss treaties, with an emphasis on the higher frequency/lower severity category of exposures. Casualty lines of business include motor, general liability, excess casualty, auto liability, employer's liability, professional liability, workers' compensation, directors and officers, errors and omissions and medical malpractice. In addition, TMR AG assumes credit insurance contracts.

The Company also provides non traditional customised reinsurance and financial solutions for its clients' world wide property and casualty exposures on both a treaty and facultative basis.

A branch in the United Kingdom ("TMRUK") was formed on 17 September 2014. On 8 April 2015, TMR AG received authorisation from the Prudential Regulation Authority ("PRA") to operate as a branch in the United Kingdom. TMRUK commenced writing business on 1 July 2015 which included the new and renewal business formerly written by TMR AG's affiliate, Tokio Millennium Re (UK) Ltd.

The Company formed a branch in the United States ("TMRUS") and was issued a license by the New York State Department of Financial Services on 2 June 2014. TMRUS was established to further expand TMR AG's non catastrophe portfolio and focuses on non catastrophe product lines.

TMR Management, Inc. ("TMRM"), a wholly owned subsidiary of the Company, was incorporated in the State of Connecticut, United States of America on 18 December 2013, with an initial share capital of USD 1,000 (authorised and issued shares of 1,000 at USD 1 per share). TMRM, pursuant to a management agreement with TMR AG, acts as a manager for TMRUS.

On 15 October 2013, the Company formed a branch in Bermuda and is licensed as a Class 3B reinsurer under the Insurance Act, 1978 of Bermuda and related regulations to write all classes of property and casualty business. The Company's branch in Switzerland, originally formed on 31 August 2010, was discontinued as part of the redomestication of the Company effective 15 October 2013.

Tokio Millennium Agency Ltd. ("TMA"), a wholly owned subsidiary of the Company, was incorporated in Bermuda on 28 May 2003, with an initial share capital of USD 12,000. Its primary activity was to facilitate risk swap agreements between Tokio Marine and Nichido Fire Insurance Co., Ltd. and other insurance companies for which it received agency fees. In 2012, TMA was renamed Tokio Solution Management Ltd. ("TSM"). The Bermuda Monetary Authority ("BMA") issued a license to TSM to conduct business as an insurance management company on 24 August 2012.

TSM manages and facilitates transactions through Shima Reinsurance Ltd. ("Shima Re") or other third party vehicles. In addition, TSM facilitates clients' fronting and leveraging agreements and also provides professional claims and loss reserving services.

The Company's wholly owned subsidiary, Shima Re, a Class 3 segregated accounts company, was incorporated under the laws of Bermuda on 30 July 2012 and registered under the Segregated Companies Act of 2000. With TSM as its manager, Shima Re provides its clients with a platform to transform either fronted or direct reinsurance transactions.

The Company formed a branch in Australia on 22 October 2010. The Australian Prudential Regulation Authority ("APRA") issued a license to the Company's Australian branch to conduct business as a general insurer on 1 March 2011.

2. BASIS OF PREPARATION

(a) Statement of compliance

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB").

When IFRS is silent, as it is in respect of the measurement of certain insurance products, the IFRS framework (IFRS 4, Insurance Contracts) allows reference to another comprehensive body of accounting principles. Accordingly, to the extent that IFRS 4 does not specify the recognition or measurement of insurance contracts, transactions reported in these consolidated financial statements have been prepared in accordance with another comprehensive body of accounting principles for insurance contracts, namely United States GAAP.

(b) Basis of measurement

The consolidated financial statements are presented in United States Dollars, which is the Company's reporting currency. They are compiled on a going concern basis. The consolidated financial statements have been prepared on the historical cost basis. See Note 3 for exceptions to this.

(c) Use of estimates and judgments

The preparation of the consolidated financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income, and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected.

The most significant estimate made by management is in relation to outstanding losses and loss expenses. Estimates in relation to losses and loss expenses are discussed in Note 3(b) – Insurance Contracts. Also, refer to Note 17 – Insurance Liabilities.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of consolidation

The financial statements consolidate the accounts of the Company, its branches, and its wholly owned subsidiaries. A subsidiary is an entity that is controlled by TMR AG. TMR AG controls an entity when it is exposed to or has the rights to variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. The financial statements of the subsidiaries are included in the consolidated financial statements from the date on which control commences until the date on which control ceases. The financial statements of the subsidiaries are prepared for the same reporting year as the parent company, using consistent accounting policies. All significant intercompany transactions and balances are eliminated on consolidation.

(b) Insurance contracts

Classification
Contracts that transfer significant insurance risk are considered insurance contracts, while contracts without significant insurance risk are classified as investment contracts.

Reinsurance premiums assumed and acquisition costs
Reinsurance premiums assumed are recorded on the accruals basis and are included in income over the period of exposure to risk with the unearned portion deferred in the consolidated balance sheet. Premiums assumed are stated before the deductions of brokerage, commissions, and taxes.

For excess of loss contracts, the ultimate premium is estimated at the contract inception. Subsequent premium adjustments, if any, are recorded in the period in which they are determined. For proportional treaties, the amount of premium is normally estimated at inception by management based on information provided by the ceding company. The Company accounts for such premium using initial estimates, which are reviewed regularly with respect to the actual premium reported by the ceding company. Changes in estimates are recognised in the period in which they are determined.

For certain property catastrophe contracts, the Company earns reinstatement premiums upon the occurrence of a loss under the reinsurance contract. Reinstatement premiums are calculated in accordance with the contract terms based upon the ultimate loss estimate associated with each contract.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(b) Insurance contracts (continued)

Premiums for retroactive exposures in reinsurance contracts are earned at the inception of the contract, as all of the underlying loss events covered by these exposures occurred in the past. Any underwriting profit at the inception related to retroactive exposures in a reinsurance contract is deferred and recognised over the estimated future payout of the outstanding losses and loss expenses. Any underwriting loss at inception related to retroactive exposures in a reinsurance contract is recognised immediately.

Premiums receivable from brokers, insureds and cedants are recognised when due and recorded net of commissions, brokerage, premium taxes and other levies on premiums, unless the contract specifies otherwise. These balances are reviewed for impairment, with any impairment loss recognised as an expense in the period in which it is determined.

Acquisition expenses, mainly commissions and brokerage, related to unearned premiums are deferred and amortised to income over the periods in which the premiums are earned. The method followed in determining the deferred acquisition expenses limits the amount of the deferral to its realisable value, by giving consideration to losses and expenses expected to be incurred as premiums are earned.

Where applicable, no claims bonuses and profit commissions are accrued based on claims experience.

Reinsurance premiums ceded
Reinsurance premiums ceded comprise the cost of reinsurance contracts entered into. Premiums ceded are accounted for in the period in which the contract is bound and are similarly earned over the period of exposure to risk, with the unearned portion being deferred in the consolidated balance sheet as prepaid reinsurance premiums.

Premiums payable to agents and brokers are recognised when due.

Outstanding losses and loss expenses
Losses and loss expenses paid are recorded when advised by the ceding insurance companies. Outstanding losses comprise estimates of the amount of reported losses and loss expenses received from the ceding insurance companies plus a provision for losses incurred but not reported (“IBNR”). The IBNR provision is estimated by management based on reports from industry sources, including initial estimates of aggregate industry losses, individual loss estimates received from ceding companies and brokers, the output from commercially available catastrophe loss models and actuarial analysis using historical data available to the Company on the business assumed together with industry data.

Given the inherent nature of major catastrophic events, considerable uncertainty underlies the assumptions and associated estimated reserve for losses and loss expenses. These estimates are reviewed regularly and, as experience develops and new information becomes known, the reserves are adjusted as necessary. Such adjustments, if any, are reflected in income in the period in which they are determined.

Due to the inherent uncertainty in estimating the liability for losses and loss expenses, there can be no assurance that the ultimate liability will not be settled for a significantly greater or lesser amount than that recorded.

Based on the current assumptions used, management believes that the Company’s recorded amount is a reasonable estimate of the ultimate cost of losses incurred to the consolidated balance sheet date. Reserves for non catastrophe property and casualty covers are based on individual claims, case reserve and other reserve estimates reported by insureds and ceding companies as well as the Company’s actuarial estimates of ultimate losses. Inherent in the estimates of ultimate losses are expected trends in claim severity and frequency and other factors which could vary significantly as claims are settled. The Company does not have the benefit of a significant amount of its own historical experience with non catastrophe lines of business. Accordingly, the setting and reserving for incurred losses in these lines of business could be subject to greater variability.

Ultimate losses may vary materially from the amounts provided in the consolidated financial statements. These estimates are reviewed regularly and, as experience develops and new information becomes known, the reserves are adjusted as necessary. Such adjustments, if any, are reflected in the consolidated statement of comprehensive income in the period in which they become known and are accounted for as changes in estimates.

Amounts recoverable from reinsurers are estimated in a manner consistent with the underlying liabilities. Reinsurance recoverable on dual trigger reinsurance contracts require the Company to estimate its ultimate losses applicable to these contracts as well as estimate the ultimate amount of industry losses that will be reported by the applicable statistical reporting agency, as per contract terms.

Liability adequacy tests
At each balance sheet date, the Company performs a liability adequacy test using current best estimates of future cash outflows generated by its reinsurance contracts, plus any investment income thereon. If, as a result of these tests, the carrying amount of the Company’s reinsurance liabilities is found to be inadequate, the deficiency is charged to income for the period, initially by writing off deferred acquisition costs and subsequently by establishing a provision.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(c) Financial instruments

Cash and cash equivalents

The Company considers all cash at bank and on hand, short term deposits and other short term highly liquid investments that are subject to insignificant risk of changes in fair value as cash and cash equivalents. Cash equivalents are financial investments with less than three months to maturity at the date of acquisition.

Cash and cash equivalents are carried in the consolidated balance sheet at amortised cost. Carrying amounts approximate fair value due to the short term nature and high liquidity of the instruments.

Funds withheld

Funds withheld are contractual receivables due to reinsurers from their clients; they are valued at original cost (nominal amount) at the date of acquisition. In addition, also included in funds withheld are amounts arising from the application of the deposit method of accounting. An appropriate allowance is made for credit risks.

Investments

The Company's investments comprise of short term investments and investments in fixed interest, equity and other securities and catastrophe bonds. The classification is determined at the time of initial purchase. Purchases and sales of investments are recognised at fair value on the trade date. Transaction costs are treated in accordance with the investment classification.

The cost of investments is adjusted for amortisation of premiums and discounts. Realised gains and losses on investments are recognised in net investment income using the specific identification method (as securities are purchased by lot). Interest income on investments is accrued to the consolidated balance sheet date.

Investments are derecognised when the Company has transferred substantially all of the risks and rewards of ownership. On derecognition of an available for sale investment, previously recorded unrealised gains and losses are removed from accumulated other comprehensive income in shareholder's equity and included in current period income.

The Company, together with its investment managers, reviews investments on an individual security basis for evidence of impairment on at least a quarterly basis as part of the financial close process. Impairment losses are recognised when there is objective evidence that the Company will be unable to collect all amounts due according to contractual terms of the individual security.

An available for sale debt security is impaired if there is objective evidence that a loss event has occurred after initial recognition of the security and up to the relevant consolidated balance sheet date, and that loss event has negatively affected the estimated future cash flows, i.e., amounts due according to the contractual terms of the security are not considered collectible. Impairment losses on available for sale debt securities are recognised by reclassifying the losses from accumulated other comprehensive income to the consolidated statement of comprehensive income. The amount reclassified is the difference between the amortised cost and the current fair value, less any impairment loss previously recognised in profit or loss. If the fair value of an impaired available for sale debt security subsequently increases and the increase can be related objectively to an event occurring after the impairment loss was recognised, then the impairment loss is reversed through profit or loss; otherwise it is reversed through other comprehensive income.

An available for sale equity security is considered to be impaired if there is objective evidence that the cost may not be recovered. Objective evidence that the cost may not be recovered, in addition to qualitative impairment criteria, includes a significant or prolonged decline in the fair value below cost. If an available for sale equity security is impaired, any further declines in the fair value at subsequent reporting dates are recognised as impairments. Therefore, at each reporting period, for an equity security that was determined to be impaired, additional impairments are recognised for the difference between the fair value and the original cost basis, less any previously recognised impairment. Reversals of impairments of available for sale equity securities are not recorded through the income statement but recycled out of other comprehensive income when sold.

The identification of impairment is an inherently uncertain process involving various assumptions and factors, including the financial condition of the counterparty, expected future cash flows, observable market prices, etc. Estimates and assumptions are based on management's judgment and other information available prior to the issuance of the consolidated financial statements. Significantly different results can occur as circumstances change and additional information becomes known.

The Company's investments are managed following prudent standards of diversification. Specific provisions limit the allowable holdings of a single issue and issuers.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(c) Financial instruments (continued)

Short term investments
Short term investments represent bank deposits and investments in money market funds with an original term of greater than 90 days but less than one year. The carrying value reported in the consolidated balance sheet for these short term investments approximates their fair value due to the short term nature of the investments.

Fixed interest securities – available for sale
This consists of debt securities which are classified as available for sale and are carried at fair value, with any unrealised gains and losses (the difference between amortised cost and fair value), with the exception of currency valuation differences, included in accumulated other comprehensive income as a separate component of equity. The amortisation and currency valuation differences are included in profit or loss.

The fair value of fixed interest securities is based on prices provided by internationally recognised independent pricing services. The independent pricing sources obtain actual transaction prices for securities that have quoted prices in active markets. For securities that are not actively traded, the pricing services typically uses the "matrix pricing" which uses observable inputs including reported trades, benchmark yields, broker/dealer quotes, interest rate spreads, prepayment spreads and other such inputs from market sources to determine a reasonable fair value.

Investments in catastrophe bonds – available for sale
The Company's investments in catastrophe bonds are classified as available for sale and are carried at fair value, with any unrealised gains and losses (difference between amortised cost and fair value), with the exception of currency valuation differences, included in accumulated other comprehensive income as a separate component of equity. The amortisation and currency valuation differences are included in profit or loss.

Equity securities – available for sale
The Company's equity securities are classified as available for sale and are carried at fair value, with any unrealised gains and losses (including currency valuation differences), included in accumulated other comprehensive income as a separate component of equity.

Other securities – fair value through profit and loss
Other securities consist of investments in investment funds organised as limited partnerships and investments in funds organised as limited liability companies. These are designated at fair value through profit or loss from the date of acquisition.

Derivative financial instruments
From time to time, the Company enters into catastrophe swap derivatives, under which certain catastrophe reinsurance exposures are ceded to or assumed from the swap counterparty. The Company does this to facilitate institutional investors who seek to diversify their portfolios by adding non-correlated reinsurance risks to their portfolio. The Company transforms such risks by selling reinsurance and buying derivatives from the institutional investors, or vice versa. The Company earns a fee for its role in facilitating such transactions. Since there is no right of offset, all transactions are presented on a gross basis in the consolidated financial statements. Although the derivatives provide an economic hedge against the assumed or ceded reinsurance contract, the Company designates its derivatives as non-hedging derivative instruments based upon criteria established by IAS 39, *Financial Instruments: Recognition and Measurement*. Catastrophe swaps are recorded at fair value with changes in fair values recorded in the consolidated statement of comprehensive income. Fair value is estimated by management primarily based on the unexpired period of risk, an evaluation of the probability of loss and other unobservable inputs. The Company's catastrophe swap derivatives are initially priced at fair value in a non-stressed market and amortisation reflects the change in fair value in the absence of any loss events. The inputs for catastrophe swap derivatives are purely based on management's evaluation and are unobservable.

Receivables
The Company's receivables have fixed or determinable payments and are carried at cost less any provision for impairment in value. Refer to Note 3(b) for discussion on receivables arising from reinsurance contracts.

Impairment of financial assets
Objective factors that are considered when determining whether a financial asset or group of financial assets may be impaired include, but are not limited to, the following:

- negative rating agency announcements in respect of investment issuers, reinsurers, and debtors;
- significant reported financial difficulties of investment issuers, reinsurers, and debtors;
- actual breaches of credit terms such as persistent late payments or actual default;
- the disintegration of the active market(s) in which a particular asset is traded or deployed; and
- adverse economic or regulatory conditions that may restrict future cash flows and asset recoverability.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(d) Deposit assets and liabilities

Certain contracts do not transfer sufficient insurance risk and are accounted for using the deposit method of accounting. Management exercises judgment in determining whether contracts contain sufficient risk to be accounted for as reinsurance contracts. Under the deposit method of accounting, the deposit asset or liability is initially measured based on the consideration paid or received. In subsequent periods, the deposit asset or liability is adjusted by calculating the effective yield on the deposit to reflect actual receipts or payments to date and future expected receipts or payments.

The Company earns fee income for the provision of these contracts. Fee income is based upon the terms of the contracts, with the unearned portion deferred in the consolidated balance sheet, as deferred fee income. The revenue and expense recorded for such contracts are included in other underwriting income.

(e) Property and equipment

Property and equipment are stated at cost less accumulated depreciation calculated on a straight line basis over the estimated useful lives of the assets. The specific depreciable rates of the significant asset classes are as follows:

Computer equipment	3 years
Fixtures and fittings	5 years
Leasehold improvements	Over the term of the underlying lease
Motor vehicles	5 years
Office equipment	4 years

(f) Intangible assets

Intangible assets are stated at cost less amortisation calculated on a straight line basis over the estimated useful lives of the assets. The Company's intangible assets comprise of computer software with a specific amortisation rate of 3 years.

(g) Impairment of non-financial assets

Assets that are subject to amortisation are tested for impairment when there is an indication of a possible impairment at the reporting date.

Objective factors that are considered when determining whether a non-financial asset (such as an intangible asset or item of property and equipment) or group of non-financial assets may be impaired include, but are not limited to, the following:

- adverse economic, regulatory or environmental conditions that may restrict future cash flows and asset usage and/or recoverability; and
- the likelihood of accelerated obsolescence arising from the development of new technologies and products; and the disintegration of the active market(s) to which the asset is related.

An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purpose of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash generating units).

Where an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, to the extent that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset in prior periods. A reversal of an impairment loss is recognised as income immediately.

(h) Bad debt provision

The Company reviews receivables on a quarterly basis. A bad debt provision is recorded only to the extent that repayment is unlikely or no longer expected in full amount. In addition, the Company considers known and emerging credit events to determine if other provisions are necessary.

(i) Translation of foreign currencies

The consolidated financial statements of the Company are presented in United States Dollars.

Foreign currency transactions are recorded in the functional currency for each entity using the exchange rates prevailing at the dates of the transactions, or at the average rate for the period when this is a reasonable approximation. Monetary assets and liabilities denominated in foreign currencies are translated at period end exchange rates. The resulting exchange differences on translation are recorded in profit or loss.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(i) Translation of foreign currencies (continued)

Non monetary assets and liabilities carried at historical cost denominated in a foreign currency are translated at historic rates. Non monetary assets and liabilities carried at fair value denominated in a foreign currency are translated at the exchange rate at the date the estimated fair value was determined, with resulting exchange differences recorded in accumulated other comprehensive income in shareholder's equity.

The functional currency of the Bermuda and United States branches is the United States Dollar. The functional currencies of the Company's Swiss, Australian and United Kingdom operations are the Euro, Australian Dollar, and British Pound, respectively. In translating the financial results of those entities whose functional currency is other than the United States Dollar reporting currency, assets and liabilities are converted into United States Dollars using the rates of exchange in effect at the balance sheet dates, and revenues and expenses are converted using the average foreign exchange rates for the period. The effect of translation adjustments is reported in the consolidated balance sheet and consolidated statement of changes in shareholder's equity as a foreign currency translation adjustment, a separate component of accumulated other comprehensive income.

(j) Leases

All leases are classified as operating leases and are not recognised in the consolidated balance sheet. Rentals payable under operating leases are charged to income on a straight line basis over the lease term.

(k) Long term incentive compensation plan

In 2008, the Board approved a compensation program for employees. The compensation program consisted of accumulation units which were based on movements in the net asset value of the Company and were settled in cash once a cliff vesting service period has been rendered. The Company accounted for the compensation program in accordance with IFRS 2, *Share based Payment*. As a liability award, the cost was remeasured at each reporting period until the settlement date. The cost of such services was recognised over the service period in the consolidated statement of comprehensive income. The grant date of the units was determined to be upon authorisation of the awards in accordance with the Company's governance structure.

In the first quarter of 2016, the Compensation and Nominations Committee of the Board approved an amendment to the compensation program which changes the metric used to calculate the value of awards. Under the amended long term incentive compensation plan, the value of awards is based on the difference between the actual profit and target profit over the performance period. This represents a change in an accounting estimate, which pursuant to IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*, is to be performed prospectively in the period under review without restatement of the comparative figures for previous periods. The financial impact of the change in valuation metric to previous periods is insignificant. Given the amendment, the Company changed the accounting for the compensation program to be in accordance with IAS 19, *Employee Benefits*.

(l) Taxation

The Switzerland operation and the Australia, United States, and United Kingdom branches of the Company operate in jurisdictions where they are subject to taxation. Income taxes have been provided for in accordance with the provisions of IAS 12, *Income Taxes*. Current and deferred income taxes are charged or credited to profit or loss. Deferred income taxes are provided for all temporary differences between the bases of assets and liabilities used in the consolidated balance sheet and those used in the various jurisdictional tax returns. Deferred tax assets are recognised for unused tax losses, unused tax credits and deductible temporary differences to the extent that it is probable that future taxable profits will be available against which they can be used. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

The Company recognises a tax benefit relating to uncertain tax positions only where the position is probable to be sustained assuming examination by tax authorities. Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, using tax rates enacted or substantively enacted at the reporting date.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income taxes relate to the same fiscal authority.

(m) Retirement benefit obligation

Defined contribution plans

TMR AG has defined contribution plans where the Company pays fixed contributions into a separate entity from which post employment and other benefits are paid. The Company has no legal or constructive obligation to pay further contributions if the plan does not hold sufficient assets to pay employees the benefits relating to employee service in the current and prior periods. Payments to the defined contribution plans are recognised as an expense when employees have rendered services entitling them to the contributions. This is generally in the year of contribution. Prepaid contributions are recognised as an asset to the extent that a cash refund or a reduction in future payments is available.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(m) Retirement benefit obligation (continued)

Defined benefit plan

The Company also has a defined benefit post retirement plan in relation to the Switzerland operation. The net retirement benefit obligation in relation to this plan is based on, among other things, assumptions of the discount rate, estimate return on plan assets, and salary increases. The cost of providing benefits is determined using the Projected Unit Credit Method, with actuarial valuations being carried out at the end of each reporting period. Actuarial gains and losses are recognised in other comprehensive income. Past service costs are recognised immediately in the period of a plan amendment. The Company recognises the overfunded or underfunded status of the defined benefit post retirement plan as an asset or liability in its consolidated balance sheet and recognises changes in the funded status in the year in which the changes occur through other comprehensive income. Any asset resulting from this calculation is limited to the sum of any cumulative unrecognised net losses and the present value of any economic benefits available in the form of refunds or reductions in future contributions to the plan.

Accounting standards and amendments issued but not yet adopted

Accounting standards issued and amendments to published standards that are not yet effective up to the date of issuance of the Company's consolidated financial statements are listed below. The Company intends to adopt these standards when they become effective.

IFRS 9, *Financial Instruments*

IFRS 9, published in July 2014, replaces the existing guidance in IAS 39, *Financial Instruments: Recognition and Measurement*. IFRS 9 includes revised guidance on the classification and measurement of financial assets and liabilities, including a new expected credit loss model for calculating impairment of financial assets, and the new general hedge accounting requirements. It also carries forward the guidance on recognition and derecognition of financial instruments from IAS 39.

IFRS 9 is effective for annual reporting periods beginning on or after 1 January 2018, with early adoption permitted. The new standard may have an effect on the classification and measurement of the Company's financial assets. The new standard also introduces expanded disclosure requirements and changes in presentation. These are expected to change the nature and extent of the Company's disclosures about its financial instruments particularly in the year of the adoption of the new standard. The Company is in the process of analysing the impact of this Standard on its consolidated financial statements.

IFRS 15, *Revenue from contracts with customers*

IFRS 15, published in May 2014, is a converged standard from the IASB and FASB on revenue recognition. IFRS 15 will improve the financial reporting of revenue and improve comparability of the top line in financial statements globally. IFRS 15 is effective for annual periods beginning on or after 1 January 2018, with early adoption permitted. The Company is in the process of analysing the impact of this Standard on its consolidated financial statements.

IFRS 16, *Leases*

On 13 January 2016, the IASB published IFRS 16, *Leases*, which replaces the current guidance in IAS 17, *Leases*. It will result in almost all leases being recognised on the balance sheet. Under IAS 17, lessees were required to make a distinction between a finance lease (on balance sheet) and an operating lease (off balance sheet). IFRS 16 now requires lessees to recognise a lease liability reflecting future lease payments and a "right of use asset" for virtually all lease contracts. The IASB included an optional exemption for certain short term leases and leases of low value assets; however, this exemption can only be applied by lessees. Under IFRS 16, a contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for a consideration.

IFRS 16 is effective for annual reporting periods beginning on or after 1 January 2019. Earlier application is permitted, but only in conjunction with IFRS 15, *Revenue from contracts with customers*. The Company is in the process of analysing the impact of this Standard on its consolidated financial statements.

Amendments to IAS 7, *Statement of cash flows, on the disclosure initiative*

These amendments to IAS 7, published in February 2016, introduce an additional disclosure that will enable users of financial statements to evaluate changes in liabilities arising from financing activities. The amendment is part of the IASB's Disclosure Initiative, which continues to explore how financial statement disclosures can be improved. The amendments are effective for annual periods beginning on or after 1 January 2017 and will have no material impact on the Company's consolidated financial statements.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Accounting standards and amendments issued but not yet adopted (continued)

Amendments to IAS 12, *Income taxes, on recognition of deferred tax assets for unrealised losses*

These amendments on the recognition of deferred tax assets for unrealised losses, published in February 2016, clarify how to account for deferred tax assets related to debt instruments measured at fair value. The amendments are effective for annual periods beginning on or after 1 January 2017 and are not expected to have a material impact on the Company's consolidated financial statements.

Amendments to IFRS 2, *Share based payments, on clarifying how to account for certain types of share based payment transactions*

This amendment published in June 2016 clarifies the measurement basis for cash settled, share based payments and the accounting for modifications that change an award from cash settled to equity settled. It also introduces an exception to the principles in IFRS 2 that will require an award to be treated as if it was wholly equity settled, where an employer is obliged to withhold an amount for the employee's tax obligation associated with a share based payment and to pay that amount to the tax authority. These amendments are effective for annual periods beginning on or after 1 January 2018 and are not expected to have an impact on the Company's results.

Amendments to IFRS 4, *Insurance contracts, regarding the implementation of IFRS 9, Financial instruments*

These amendments, published in September 2016, introduce two approaches: an overlay approach and a deferral approach. The amended standard will:

- give all companies that issue insurance contracts the option to recognise in other comprehensive income, rather than profit or loss, the volatility that could arise when IFRS 9 is applied before the new insurance contracts standard is issued; and
- give companies whose activities are predominantly connected with insurance an optional temporary exemption from applying IFRS 9 until the year 2021. The entities that defer the application of IFRS 9 will continue to apply the existing financial instruments standard – IAS 39, *Financial Instruments: Recognition and Measurement*.

Both the temporary exemption and the overlay approach allow entities to avoid temporary volatility in profit or loss that might result from adopting IFRS 9 before the forthcoming new insurance contracts standard. Furthermore, by using the temporary exemption, an entity does not have to implement two sets of major accounting changes within a short period, and it can take into account the effects of the new insurance standard when first applying the classification measurement requirements of IFRS 9.

The amendments are effective for annual periods beginning on or after 1 January 2018. The Company is in the process of reviewing and analysing the impact of these amendments.

Annual improvements to IFRSs 2014 – 2016 cycle

In December 2016, the IASB published its annual amendments to IFRSs and the related bases for conclusions and guidance. The IASB uses the annual improvements process to make necessary, but non urgent, amendments to IFRSs that will not be included as part of a major project. These amendments affect three standards, namely:

- IFRS 1, *First time Adoption of IFRS*, regarding the deletion of short term exemptions for first time adopters regarding: IFRS 7, *Financial Instruments: Disclosures*; IAS 19, *Employee Benefits*; and IFRS 10, *Consolidated Financial Statements*, effective 1 January 2018;
- IFRS 12, *Disclosure of Interests in Other Entities*, regarding clarification of the scope of the standard. These amendments should be applied retrospectively for annual periods beginning on or after 1 January 2017; and
- IAS 28, *Investments in Associate and Joint Ventures*, regarding measuring an associate or joint venture at fair value, effective 1 January 2018.

These amendments will have no material impact on the Company's consolidated financial statements.

4. RISK DISCLOSURES

The Company, through its Enterprise Risk Management ("ERM") function, Risk Management Working Group ("RMWG") and Risk Management Committee ("RMC"), seeks to identify all material risks inherent in its business including emerging risks; to understand the manifestations of each risk; and to assess, control, mitigate and manage these risks appropriately.

The objectives of TMR AG's risk management process are to ensure that:

- all material risks are proactively identified;
- the potential to cause losses or generate profits is understood and assessed;
- appropriate action is taken to manage the assumption of each risk based on that assessment and the Company's stated risk appetite;
- appropriate controls are in place to mitigate risks;
- an appropriate level of capital is held to cover financial and non financial risks from all sources; and
- following a severe catastrophic event(s), appropriate capital action can be executed to remain solvent and meet its obligations under reinsurance contracts.

The oversight of the Company's risk management program is provided by the Board of Directors and senior management who are assisted by the RMC.

In the course of the Company's risk identification, assessment, control, monitoring and reporting process, it has identified and categorised all of its risks into the following categories:

- underwriting risk including premium risk, catastrophe risk, and reserve risk;
- market risk including interest rate risk, foreign exchange risk, revaluation risk, equity price risk, and credit spread risk;
- credit risk;
- liquidity risk;
- operational risk; and
- strategic risk.

A. Underwriting risk

Underwriting risk consists of premium risk, catastrophe risk and reserve risk.

Underwriting risk may be due to either the acceptance of risks that do not comply with the Company's underwriting guidelines and corporate strategy or the acceptance of risks that result in losses and expenses greater than it had anticipated at the time of underwriting.

As a reinsurance company, TMR AG is in the business of taking underwriting risk and therefore has a high appetite for underwriting risk. TMR AG's risk limits are defined in its Risk Appetite and Risk Tolerance/Limit Policy for underwriting risk and reserve risk combined.

The Company has underwriting guidelines in place that clearly define the territorial scope, risks to be written, business to be avoided, acceptance limits, maximum policy period, maximum net retention, outward reinsurance, security requirement (for retrocessionaires) and underwriting authority.

As a part of the risk control strategy and governance at TMR AG, all contracts must be reviewed and approved by an Underwriting Committee before they can be bound.

The Company employs experienced catastrophe analysts and modelers, as well as experienced and credentialed actuaries, to perform pricing analyses to ensure that each risk is adequately priced.

Premium risk

Premium risk is the risk that the premium to be earned over the next twelve month period from the in-force, new or renewal reinsurance contracts is insufficient to cover the claim costs, claim adjustment expenses as well as the acquisition costs to be incurred by those contracts over the same period.

The Company has purchased retrocessions in the past several years to enhance the diversity of the portfolio, improve capital efficiency, manage the net retention and protect the capital of TMR AG. The Company will continue to utilise this important risk management tool when the pricing and risk mitigation impact justifies doing so.

4. RISK DISCLOSURES (continued)

A. Underwriting risk (continued)

Premium risk (continued)

Details of annual premiums assumed by geographic area of risk insured are provided below:

	2016		2015	
USD '000	Reinsurance premiums assumed	%	Reinsurance premiums assumed	%
Geographic area of risk insured				
North America	987,367	63.6%	1,260,401	81.5%
Europe	285,653	18.4%	150,418	9.7%
Worldwide	186,429	12.0%	85,964	5.6%
Australasia	56,175	3.6%	40,673	2.6%
Asia	35,523	2.3%	1,361	0.1%
Other	1,493	0.1%	7,471	0.5%
Total	1,552,640	100.0%	1,546,288	100.0%

Details of annual premiums assumed by line of business are provided below:

	2016		2015	
USD ‘000	Reinsurance premiums assumed	%	Reinsurance premiums assumed	%
Line of business				
Property catastrophe	342,251	22.0%	396,787	25.7%
Property	246,973	15.9%	464,678	30.0%
Casualty	709,866	45.7%	539,041	34.9%
Specialty	127,434	8.2%	93,137	6.0%
Multi line	126,116	8.2%	52,645	3.4%
Total	1,552,640	100.0%	1,546,288	100.0%

Catastrophe risk

Catastrophe risk is the risk that the premium to be earned over the next twelve month period from the catastrophe exposed reinsurance contracts (in force, new or renewal) is insufficient to cover potential claim costs, claim adjustment expenses as well as the acquisition costs associated with those contracts that may originate from extreme or exceptional catastrophic events over the same period, such as hurricanes, earthquakes, windstorms, landslides and terrorist attacks.

Catastrophe risk is classified as a separate and distinct class of underwriting risk mainly due to its low frequency and high severity characteristics, its potential to affect numerous contracts simultaneously and inflict significant erosion of TMR AG’s capital.

A core element of TMR AG’s book of business continues to be property catastrophe reinsurance. Therefore, TMR AG has a high appetite for catastrophe risk as long as this business is adequately priced. The Company writes reinsurance risks for periods of mainly one year so that the contracts can be assessed for pricing and terms and adjusted to reflect any changes in market conditions.

The Company has made a series of strategic moves to diversify, spread and dilute its catastrophe exposures as well as optimise its underwriting portfolio through geographical diversification and by writing casualty and specialty lines and lower layers of business.

Catastrophe risk is the dominant contributor and driver of TMR AG’s total risk. TMR AG’s catastrophe exposures are managed by limiting the amount of exposure in any one geographic area.

Retrocession is purchased to enhance the diversity of TMR AG’s portfolio, maintain the net retention and even out peak exposures and more effectively manage the volatility of TMR AG’s book of business.

4. RISK DISCLOSURES (continued)

A. Underwriting risk (continued)

Reserve risk

Reserve risk is the risk that the best (point) estimate of unpaid loss and loss adjustment expense reserves are inadequate to cover all future payments for the full settlement of claims from all prior accident years (on or prior to the valuation date).

Reserve risk is distinct from premium risk and is related to exposures that have already been earned and claims that have already been incurred but have not yet been reported ("IBNR") or fully settled.

TMR AG has focused on short tailed property lines of business in the past but now has increased its appetite for longer tailed casualty and specialty lines of business. The proportion of medium and long tailed lines of business underwritten by the Company continues to create a shift towards a greater proportion of reserving risk in the risk profile. TMR AG's risk limits are not defined separately for catastrophe risk, non catastrophe premium risk and reserve risk, but are defined for insurance risk as a whole.

To manage reserving risk, TMR AG's actuarial team use a range of recognised actuarial techniques to project gross premiums written, monitor claims development patterns and stress test ultimate insurance liability balances. An independent actuary also performs a quarterly review for the Company.

A full analysis of loss and loss adjustment expense reserves is performed on a quarterly basis. The reserve analyses are reviewed by and discussed with underwriters, actuaries, claims, finance and senior management prior to submission to the Reserve Committee. The Reserve Committee is appointed by the Executive Committee to review the sufficiency of the estimated loss reserves and to appraise the adequacy and effectiveness of the loss reserving practices of TMR AG. The Reserve Committee is comprised of the Chief Executive Officer ("CEO"), Chief Risk Officer ("CRO"), Chief Operating Officer ("COO"), Chief Financial Officer ("CFO"), Claims unit leader and the reserving actuary.

The table below illustrates the development of the estimates of ultimate cumulative claims for the Company after the end of the accident year, illustrating how amounts estimated have changed from the first estimate made.

Estimate of gross ultimate liability

USD '000	2009	2010	2011	2012	2013	2014	2015	2016	Total
At end of accident year	43,975	191,957	515,356	324,587	306,172	431,405	559,407	757,851	
One year later	46,829	206,494	529,491	318,895	306,962	428,287	547,292		
Two years later	45,644	213,431	504,483	317,360	296,375	415,797			
Three years later	45,104	222,238	523,370	308,435	286,511				
Four years later	48,962	231,680	517,826	304,045					
Five years later	46,231	223,342	515,669						
Six years later	46,105	224,789							
Seven years later	45,925								
Ultimate liability 2009 – 2016	45,925	224,789	515,669	304,045	286,511	415,797	547,292	757,851	3,097,879
Ultimate liability pre-2009									442,332
									3,540,211
Paid – 2009–2016	(45,624)	(184,044)	(483,166)	(254,988)	(214,598)	(300,168)	(299,435)	(202,362)	(1,984,385)
Paid – pre-2009									(441,167)
									(2,425,552)
Gross liability At 31 December 2016									1,114,659

4. RISK DISCLOSURES (continued)

A. Underwriting risk (continued)

Reserve risk (continued)

Estimate of net ultimate liability

USD ‘000	2009	2010	2011	2012	2013	2014	2015	2016	Total
At end of accident year	31,810	170,263	377,402	254,757	305,924	386,508	552,426	728,211	
One year later	38,565	169,950	389,664	251,442	306,438	383,075	539,716		
Two years later	38,249	167,065	369,326	246,004	297,565	379,977			
Three years later	38,064	181,156	389,245	242,263	287,695				
Four years later	42,028	190,598	383,064	238,001					
Five years later	39,312	183,547	380,907						
Six years later	39,314	184,994							
Seven years later	39,315								
Ultimate liability 2009 – 2016	39,135	184,994	380,907	238,001	287,695	379,977	539,716	728,211	2,778,636
Ultimate liability pre-2009									389,934
									3,168,570
Paid – 2009 – 2016	(38,900)	(144,280)	(350,098)	(194,209)	(213,676)	(301,225)	(293,541)	(194,074)	(1,730,003)
Paid – pre-2009									(388,883)
									(2,118,886)
Net liability At 31 December 2016									1,049,684

A summary of changes in outstanding losses and loss expenses for 2016 and 2015, including outstanding losses recoverable from reinsurers, is presented in Note 17.

The reserves established can be more or less than adequate to meet individual claims arising. The level of uncertainty varies significantly from class to class but can arise from inadequate case reserves for known large losses and catastrophes or from inadequate provision for IBNR. The Company believes that the loss reserves established are adequate, however, a 1% improvement/deterioration in the total estimated losses would have an impact on profit before tax of USD 11.1 million gain/loss (2015 – USD 8.6 million). There was no change to the Company’s reserving methodology during the year.

4. RISK DISCLOSURES (continued)

B. Market risk

Market risk refers to the risk of financial loss due to a change in the value of the financial assets in TMR AG's investment portfolio or a change of market risk factors that affect the value of such assets. TMR AG has identified interest rate risk, foreign exchange risk, revaluation risk, equity price risk and credit spread risk as its main sources of market risk.

Interest rate risk

Interest rate risk is a function of general economic and financial market factors (such as the level, trend and volatility of interest rates) as well as the characteristics of the individual fixed interest securities held in TMR AG's investment portfolio. TMR AG cannot control the former but it can control the latter.

Investment guidelines are established to manage this risk. These guidelines set parameters within which the external investment manager must operate. The guidelines are set by the Investment Committee. The Investment Guidelines specify the limitations on the maximum percentage of assets that can be invested in a single issuer or in a single asset class. There are also specific limitations on the maximum maturity for various classes of fixed interest securities and the minimum requirements of credit ratings. The Company reviews the composition, duration and asset allocation of its investment portfolio on a regular basis in order to respond to changes in interest rates and other market conditions. The Company also mitigates interest rate risk on the investment portfolio by establishing and monitoring duration ranges in its investment guidelines.

The investment mix of the fixed interest portfolios is as follows:

At 31 December 2016 – USD '000	Fair value	%
US Treasuries	143,364	7.1%
Non-US government	87,857	4.3%
Corporate	930,336	46.1%
Agency residential mortgage backed	286,598	14.2%
Commercial mortgage backed	52,377	2.6%
Asset backed	133,787	6.6%
Collateralised debt obligations	169,156	8.4%
Municipals	215,023	10.7%
Total fixed interest securities	2,018,498	100.0%

At 31 December 2015 – USD '000	Fair value	%
US Treasuries	280,148	16.7%
Non-US government	59,274	3.5%
Corporate	733,798	43.7%
Agency residential mortgage backed	219,470	13.1%
Commercial mortgage backed	57,029	3.4%
Asset backed	75,622	4.5%
Collateralised debt obligations	161,348	9.6%
Municipals	92,228	5.5%
Total fixed interest securities	1,678,917	100.0%

4. RISK DISCLOSURES (continued)

B. Market risk (continued)

The sensitivity of the Company's fixed interest investment portfolio to interest rate movements is detailed below, assuming linear movements in interest rates:

Immediate shift in yield (basis points) – USD '000	2016	%	2015	%
100	(61,548)	(3.0)	(52,451)	(3.1)
75	(47,034)	(2.3)	(39,413)	(2.3)
50	(30,807)	(1.5)	(26,340)	(1.6)
25	(15,737)	(0.8)	(13,049)	(0.8)
(25)	15,509	0.8	12,977	0.8
(50)	29,997	1.5	25,849	1.5
(75)	44,694	2.2	37,426	2.2
(100)	56,443	2.8	47,430	2.8

The above shows the possible impact to unrealised gain (loss) on investments, a component of accumulated other comprehensive income.

The durations of the managed portfolios are as follows:

	2016	2015
Fixed interest securities	3.1	3.2

Foreign exchange risk

The Company operates internationally and its exposures to foreign exchange risk arise primarily with respect to the United States Dollar, Australian Dollar, Euro, British Pound, and New Zealand Dollar. The presentation currency of the Company is the United States Dollar in which the Company reports its consolidated financial results. The effect of this on foreign exchange risk is that TMR AG is exposed to fluctuations in exchange rates for non-United States Dollar denominated transactions and net assets.

4. RISK DISCLOSURES (continued)

B. Market risk (continued)

Foreign exchange risk (continued)

The Company hedges non United States Dollar liabilities with non United States Dollar assets to mitigate against this risk. The Company's assets and liabilities, categorised at their translated carrying amounts at 31 December 2016, are as follows:

Assets – USD '000	USD	AUD	EUR	NZD	GBP	Other	Total
Cash and cash equivalents	133,990	17,766	62,688	58,597	17,129	23,605	313,775
Funds withheld	49,064	–	19,479	–	–	3,225	71,768
Investments	1,896,153	125,994	168,086	–	66,052	–	2,256,285
Accrued interest receivable	10,684	1,227	1,659	–	581	–	14,151
Premiums receivable	646,141	27,834	48,578	12,180	89,613	32,424	856,770
Deposit assets	–	–	239,564	–	154,259	–	393,823
Prepaid reinsurance premiums	53,817	2,095	–	81	1,036	1,155	58,184
Fair value of derivative assets	2,638	–	–	–	–	1,322	3,960
Outstanding losses recoverable from reinsurers	52,934	2,948	2,733	5,368	92	900	64,975
Deferred acquisition expenses	296,544	12,449	10,664	6,650	25,636	7,891	359,834
Unearned profit commission	2,172	3	42	–	510	37	2,764
Current tax asset	890	–	–	–	192	–	1,082
Deferred tax asset	208	–	–	–	1,130	845	2,183
Property and equipment	7,565	80	1,900	–	28	–	9,573
Intangible assets	8,871	–	286	–	5	–	9,162
Other assets	6,202	36	8,300	–	4	490	15,032
Total assets at 31 December 2016	3,167,873	190,432	563,979	82,876	356,267	71,894	4,433,321

Liabilities – USD '000	USD	AUD	EUR	NZD	GBP	Other	Total
Outstanding losses and loss expenses	809,097	23,954	87,226	65,063	81,198	48,121	1,114,659
Liability for collateral held on behalf of counterparties	3,699	15	181,283	–	–	539	185,536
Reinsurance balances payable	77,254	9,177	471	125	3,451	2,684	93,162
Deposit liabilities	–	–	239,564	–	154,259	–	393,823
Payable for investments purchased	7,947	–	–	–	–	–	7,947
Unearned premiums	960,004	66,810	44,033	16,873	120,524	28,807	1,237,051
Fair value of derivative liabilities	2,649	–	–	–	–	1,359	4,008
Deferred commission income	5,457	262	–	12	232	102	6,065
Accounts payable and accrued expenses	29,145	2,829	4	–	1,870	2,118	35,966
Retirement benefit obligation	–	–	–	–	–	4,497	4,497
Deferred fee income	1,607	–	–	–	1,773	279	3,659
Current tax liability	–	1,062	–	–	–	–	1,062
Deferred tax liability	–	129	–	–	–	–	129
Note payable	25,000	–	–	–	–	–	25,000
Total liabilities at 31 December 2016	1,921,859	104,238	552,581	82,073	363,307	88,506	3,112,564

4. RISK DISCLOSURES (continued)

B. Market risk (continued)

Foreign exchange risk (continued)
The Company's assets and liabilities, categorised at their translated carrying amounts at 31 December 2015, are as follows:

Assets – USD '000	USD	AUD	EUR	NZD	GBP	Other	Total
Cash and cash equivalents	162,327	14,260	29,869	52,628	8,750	11,203	279,037
Funds withheld	56,891	–	21,972	–	–	133	78,996
Investments	1,666,886	118,100	206,796	–	–	1,995	1,993,777
Accrued interest receivable	8,013	1,151	2,871	–	–	–	12,035
Premiums receivable	596,648	19,335	35,113	1,203	40,271	23,829	716,399
Deposit assets	–	–	296,177	–	–	–	296,177
Prepaid reinsurance premiums	35,062	1,500	–	161	247	706	37,676
Fair value of derivative assets	1,751	–	–	–	–	3,022	4,773
Outstanding losses recoverable from reinsurers	47,157	4,484	721	–	–	368	52,730
Deferred acquisition expenses	300,777	9,114	5,327	135	7,136	5,449	327,938
Unearned profit commission	5,599	357	20	–	16	79	6,071
Current tax asset	–	1,234	–	–	–	–	1,234
Deferred tax asset	–	287	–	–	–	2,734	3,021
Property and equipment	9,290	105	2,386	–	59	–	11,840
Intangible assets	8,118	–	301	–	10	–	8,429
Other assets	5,495	31	13,633	–	–	1,464	20,623
Total assets at 31 December 2015	2,904,014	169,958	615,186	54,127	56,489	50,982	3,850,756

Liabilities – USD '000	USD	AUD	EUR	NZD	GBP	Other	Total
Outstanding losses and loss expenses	673,440	28,501	61,505	76,059	1,439	16,756	857,700
Liability for collateral held on behalf of counterparties	3,942	16	229,659	–	–	–	233,617
Reinsurance balances payable	69,373	13,036	968	75	289	5,366	89,107
Deposit liabilities	–	–	296,177	–	–	–	296,177
Payable for investments purchased	8,748	–	–	–	–	–	8,748
Unearned premiums	925,818	51,918	34,554	1,092	47,584	22,381	1,083,347
Fair value of derivative liabilities	1,203	–	–	–	–	3,104	4,307
Deferred commission income	3,220	174	–	21	26	70	3,511
Accounts payable and accrued expenses	25,080	2,053	–	–	6,357	3,075	36,565
Retirement benefit obligation	–	–	–	–	–	3,284	3,284
Deferred fee income	1,950	–	–	–	–	843	2,793
Current tax liability	–	–	–	–	–	–	–
Deferred tax liability	706	–	–	–	–	–	706
Note payable	25,000	–	–	–	–	–	25,000
Total liabilities at 31 December 2015	1,738,480	95,698	622,863	77,247	55,695	54,879	2,644,862

4. RISK DISCLOSURES (continued)

B. Market risk (continued)

Foreign exchange risk (continued)

At 31 December 2016, the Company used closing rates of exchange for major currencies of: USD 1: AUD 1.39; USD 1: EUR 0.95; USD 1: NZD 1.44 and USD 1: GBP 0.81.

At 31 December 2015, the Company used closing rates of exchange for major currencies of: USD 1: AUD 1.37; USD 1: EUR 0.91; USD 1: NZD 1.46 and USD 1: GBP 0.67.

The impact on net income of a proportional foreign exchange movement of 10% up and 10% down against the United States Dollar at the year end closing rates, applied on foreign currency net assets, would be an increase or decrease of USD 7.5 million (2015: USD 4.0 million). This analysis assumes that all other variables, in particular interest rates, remain constant and that the underlying valuation of assets and liabilities in their base currency is unchanged.

Revaluation risk

The Company is subject to revaluation risk as a result of the translation into the Company's United States Dollar reporting currency of the consolidated balance sheet of the Company's Swiss, Australian, and United Kingdom operations, whose functional currencies are the Euro, Australian Dollar, and British Pound, respectively.

Equity price risk

TMR AG is exposed to equity price risk through its holdings of equity investments. The Company holds equity investments to diversify its investment portfolio and take advantage of expected long term returns. Investment limits as set out in TMR AG's investment principles are used to manage and monitor these exposures. Equity investments are limited to a relatively small proportion of TMR AG's overall investment portfolio and the equity holdings involved are diversified over a number of companies.

Risks from changes in equity prices are normally associated with decreasing share prices and increasing equity price volatilities. As stock markets also might increase, opportunities may arise from equity investments.

As of 31 December 2016, TMR AG's equity investments amounting to a fair value of USD 40.3 million (2015 – USD 35.6 million), would have lost USD 4.0 million (2015 – USD 3.6 million) in value assuming equity markets declined by 10%. A 10% upward movement is estimated to have an equal but opposite effect. This is the possible impact to unrealised gain/loss on investments, a component of accumulated other comprehensive income.

Credit spread risk

Our investment strategy acknowledges the risk of declining market values for our fixed interest securities due to the widening of credit spreads. Investment limits per portfolio as set out in TMR AG's investment principles are used to manage and monitor this risk. The advantage of being able to invest in long duration securities gives the Company the opportunity to invest in securities yielding spreads over the risk free return and earning this additional yield component.

C. Credit risk

Credit risk is the risk of potential financial loss due to unexpected default, or deterioration in the credit ratings, of the debtors or counterparties of TMR AG.

Asset credit risk may arise from the unexpected default, or deterioration in the credit ratings, of the debtors or issuers of the financial instruments that TMR AG holds in its investment portfolio, which may cause them to lose value.

Credit risk on premiums receivable from cedants is managed by conducting business with reputable broking organisations, with whom the Company has established relationships, and by rigorous cash collection procedures. The Company also has a broker approval process in place.

4. RISK DISCLOSURES (continued)

C. Credit risk (continued)

The table below presents an analysis of the Company's major exposures to counterparty credit risk, based on Standard & Poor's (S&P) or equivalent rating.

2016							
USD '000	Cash and cash equivalents	Funds withheld	Investments [1]	Premiums receivable	Deposit assets	Losses recoverable	Derivative assets
AAA	–	–	288,624	–	–	–	–
AA+, AA, AA-	191,557	17,196	804,935	165,951	–	–	–
A+, A, A-	122,218	48,112	443,478	325,349	–	32,683	–
BBB+, BBB, BBB-	–	2,367	457,447	19,405	–	–	–
Other/Unknown [2]	–	4,093	261,801	346,065	393,823	32,292	3,960
Total	313,775	71,768	2,256,285	856,770	393,823	64,975	3,960

2015							
USD '000	Cash and cash equivalents	Funds withheld	Investments [1]	Premiums receivable	Deposit assets	Losses recoverable	Derivative assets
AAA	–	–	228,460	–	–	–	–
AA+, AA, AA-	61,906	56,045	720,179	156,816	–	–	–
A+, A, A-	217,131	16,941	458,827	266,961	–	42,243	–
BBB+, BBB, BBB-	–	3,933	451,167	23,629	–	–	–
Other/Unknown [2]	–	2,077	135,144	268,993	296,177	10,487	4,773
Total	279,037	78,996	1,993,777	716,399	296,177	52,730	4,773

(1) Investments comprise of short term investments, fixed interest securities, catastrophe bonds, equity securities, and other securities

(2) Losses recoverable, deposit assets, and derivative assets classified as "Other/Unknown" are fully collateralised

The following table shows premiums receivable that are past due but not impaired:

USD '000	2016	2015
Less than 90 days past due	7,363	18,021
Between 91 and 180 days past due	107	921
Over 180 days past due	494	466
Total	7,964	19,408

TMR AG has a medium credit risk appetite and elects to take limited credit risk. TMR AG's investment portfolio is appropriately diversified to limit the amounts of credit exposure with respect to particular rating categories and any one issuer. The Investment Committee has established comprehensive guidelines for the Company's investment managers regarding the type, duration, and quality of investments acceptable to TMR AG. The performance of investment managers is regularly reviewed to confirm adherence to these guidelines.

TMR AG is also exposed to various counterparty credit risks in the course of conducting its underwriting activities. For example, the Company may have a significant amount of premiums receivables held by its brokers, clients or retrocessionaires.

The Company may have posted funds or collateral with clients or other parties as required by the reinsurance contracts. It may have cash deposits in a number of banking institutions. A retrocessionaire may fail to meet its obligations under the retrocession contracts.

This type of credit risk is called counterparty credit risk, which is modeled as a set of frequency severity distributions resulting from the scenario analyses conducted and maintained by the Enterprise Risk Management unit using TMR AG's risk register.

To control and mitigate counterparty credit risk, the rules of the Company's Risk Appetite and Risk Limit policy concerning counterparty credit risk apply. Most of the retrocessions are either collateralised or placed with highly rated reinsurers. TMR AG transacts most of its reinsurance businesses through major and reputable brokers and spreads its cash deposits across a number of reputable commercial banks.

4. RISK DISCLOSURES (continued)

C. Credit risk (continued)

In addition, a retrocession arrangement may be made with a retrocessionaire who does not meet the criteria in the Risk Appetite and Risk Limit Policy if collateral with an equivalent or better rating than the minimum A- rating is obtained for an amount at least equal to 100% of the retroceded limit.

At 31 December 2016, the Company's credit risk exposure in relation to losses recoverable from unrated counterparties to reinsurance ceded agreements is USD 32.3 million (2015 – USD 10.5 million), which is fully collateralised by letters of credit and assets held in trusts by the reinsurance counterparty for the benefit of the Company.

At 31 December 2016, the Company's exposure to credit risk of the counterparties to catastrophe swap agreements is USD 4.0 million (2015 – USD 4.8 million), which is fully collateralised by letters of credit and assets held in trusts by the reinsurance counterparty for the benefit of the Company.

D. Liquidity risk

Liquidity risk is the risk that the Company is unable to meet its contractual obligations in a timely manner due to the inability of its investment assets to be sold without causing a significant movement in the price and with minimum loss of value.

TMR AG aims to keep liquidity risk as low as possible so that the Company will be able to meet its contractual obligations in a timely manner, even under stressed scenarios such as following a major catastrophic event. The Company maintains sufficient liquid assets, or assets that can be converted into cash at short notice and without any significant capital loss, to meet expected cash flow requirements. These liquid assets are regularly monitored using cash flow forecasting to ensure that surplus funds are invested to achieve a higher rate of return. The Company also monitors market changes and outlooks and reallocates assets as deemed necessary.

Liquidity risk can be an outcome or consequence of the Company's exposures to catastrophe risk and market risk. However, for the purpose of monitoring risk limits, liquidity risk is included in and shares the risk limit with the market risk category.

The maturity dates of the Company's fixed interest portfolio are as follows:

USD '000	2016	2015
Less than one year	204,702	90,810
Between one and two years	264,958	302,488
Between two and three years	192,322	238,889
Between three and four years	153,803	159,737
Between four and five years	210,526	118,616
Over five years	135,246	162,680
Agency residential mortgage backed	286,598	219,470
Commercial mortgage backed	52,377	57,029
Asset backed securities	133,787	75,622
Collateralised debt obligations	169,156	161,348
Municipals	215,023	92,228
Total fixed interest securities	2,018,498	1,678,917

4. RISK DISCLOSURES (continued)

D. Liquidity risk (continued)

The maturity profile of the financial liabilities of the Company is as follows:

	Years until liability becomes due				
At 31 December 2016 – USD '000	Less than one	One to three	Three to five	Over five	Total
Outstanding losses and loss expenses	300,018	361,779	183,249	269,613	1,114,659
Liability for collateral held on behalf of counterparties	39,887	37,776	32,813	75,060	185,536
Reinsurance balances payable	92,922	240	–	–	93,162
Deposit liabilities	75,977	77,637	60,700	179,509	393,823
Payable for investments purchased	7,947	–	–	–	7,947
Fair value of derivative liabilities	4,008	–	–	–	4,008
Accounts payable and accrued expenses	28,284	5,619	1,488	575	35,966
Note payable	25,000	–	–	–	25,000
Total	574,043	483,051	278,250	524,757	1,860,101

	Years until liability becomes due				
At 31 December 2015 – USD '000	Less than one	One to three	Three to five	Over five	Total
Outstanding losses and loss expenses	259,398	280,655	123,654	193,993	857,700
Liability for collateral held on behalf of counterparties	63,939	82,483	40,146	47,049	233,617
Reinsurance balances payable	88,948	159	–	–	89,107
Deposit liabilities	59,981	82,483	40,146	113,567	296,177
Payable for investments purchased	8,748	–	–	–	8,748
Fair value of derivative liabilities	3,537	770	–	–	4,307
Accounts payable and accrued expenses	29,584	4,521	1,738	722	36,565
Note payable	–	25,000	–	–	25,000
Total	514,135	476,071	205,684	355,331	1,551,221

While the estimation of the ultimate liability for outstanding losses and loss expenses is complex and incorporates a significant amount of judgment, the timing of payment of outstanding losses and loss expenses is also uncertain and cannot be predicted as simply as for other financial liabilities. Actuarial and statistical techniques, past experience and management's judgment have been used to determine a likely settlement pattern.

4. RISK DISCLOSURES (continued)

E. Operational risk

Operational risk refers to the risk of financial or other loss, or potential damage to the Company's reputation resulting from inadequate or failed internal processes, people and systems or from external events.

The following are some of the examples of operational risks facing the Company:

- legal and compliance risk;
- information technology risk (including cyber risk);
- loss of key officers or employees;
- system failure and business disruption;
- execution errors;
- employment practice liability; and
- internal and external fraud.

Through the scenario analysis process, TMR AG has also made efforts to identify and assess the financial impact of various operational risks. These risks are managed through internal control and monitoring tools such as the risk register.

TMR AG has a low appetite for operational risk. Unlike underwriting and investment risks, operational risk has no upside and only downside and therefore should be avoided if feasible and cost effective.

Operational risk is difficult to quantify but can be controlled through appropriate corporate governance and internal control measures. The Company has developed a number of policies and procedures aimed to control or mitigate the negative impact that may potentially result from operational risk events.

F. Strategic risk

Strategic risk is the risk to earnings or capital arising from adverse business decisions or improper implementation of those decisions or inability to act in response to business opportunities or to adapt to changes in its operating environment.

The following are examples of strategic risks facing the Company:

- industry overcapacity that results in prolonged soft market conditions;
- flawed response plans to market price cycles, including maintaining premium volume and market share during market declines and improper performance incentives for underwriters and others;
- planning processes (e.g., plan loss ratio setting, target premium volume) that are not fully integrated with internal financial indicators and external benchmarks or are based on forecasts that are inherently optimistic;
- expansion into new lines or territories with inadequate underwriting expertise, pricing systems, price monitoring capabilities, understanding of regulatory requirements, claims handling staff; and
- failure of large information technology and infrastructure projects to achieve the specified goals.

Strategic risks can be split into two components, one being the risk emanating from making business decisions (active) such as the last two risks in the list above, and the other emanating from a lack of response to industry challenges (passive) such as the first three risks in the list above.

Strategic risk is especially important for TMR AG because it has optimised the risk profile of its business by growing those lines of business which help to diversify its concentration in catastrophe exposures. Although there is inherent risk in such strategic expansion into new lines and geographical areas, there are also many benefits. In setting TMR AG's appetite for this risk, both the risk and the benefits are taken into consideration.

TMR AG identifies and assesses various strategic risks within its risk register and performs scenario analyses to evaluate the potential financial impact that may arise from such risks.

New business will be evaluated periodically to determine whether or not it has met the strategic goals of the Company.

4. RISK DISCLOSURES (continued)

Capital model

The Company attempts to identify and appropriately define all material risks internal and external to the Company, understand the manifestations of each risk, and ensure that risks are managed, controlled or mitigated. To the extent that a risk is not fully mitigated, the Company will measure the financial impact of the risk and include it in its capital adequacy assessment and measurement framework. The internal capital model covers all of the material risks identified above, including regulatory obligations.

Each of the material risks is measured and modeled by TMR AG's internal or third party vendor models. The results are aggregated into a probability distribution of the Company's profit and loss (via Monte Carlo simulation) in order to provide a holistic view of all risks facing the Company. In the risk aggregation process, both risk correlation and diversification effects are taken into account. From the probability distribution, the Company's overall capital requirements using various risk measures and under various capital standards can be determined.

5. CASH AND CASH EQUIVALENTS

Cash and cash equivalents represent cash at bank of USD 313.8 million at 31 December 2016 (2015 – USD 279.0 million).

6. FUNDS WITHHELD

Funds withheld at 31 December 2016 totalling USD 71.8 million (2015 – USD 79.0 million) represents funds furnished by the Company to its cedants and are largely held in trusts by trustees. The funds do not trigger any cash flows and cannot be realised by cedants without the Company's consent. In the event of default on such a deposit, the Company's reinsurance commitment would be reduced to the same extent.

7. INVESTMENTS

Investments comprise of the following:

USD '000	2016	2015
Short term investments	177,979	255,624
Fixed interest securities, available for sale	2,018,498	1,678,917
Investment in catastrophe bonds, available for sale	3,154	10,276
Equity securities, available for sale	40,343	35,646
Other securities, at fair value through profit and loss	16,311	13,314
	2,256,285	1,993,777

(a) Short term investments

The Company's short term investments represent bank deposits and investments in money market funds with an original term of greater than 90 days but less than one year. At 31 December, short term investments comprised of the following:

USD '000	2016	2015
Money market funds	117,377	137,524
Fixed deposits	60,602	118,100
	177,979	255,624

7. INVESTMENTS (continued)

(b) Fixed interest securities, available for sale

(i) The amortised cost, fair value and unrealised gains and losses of investments in available for sale fixed interest securities are as follows:

At 31 December 2016 – USD '000	Amortised cost	Unrealised gains	Unrealised losses	Fair value
US Treasuries	145,815	508	(2,959)	143,364
Non-US government	87,119	1,004	(266)	87,857
Corporate	930,685	3,608	(3,957)	930,336
Agency residential mortgage backed	292,213	634	(6,249)	286,598
Commercial mortgage backed	56,299	214	(4,136)	52,377
Asset backed	133,968	196	(377)	133,787
Collateralised debt obligations	167,915	2,210	(969)	169,156
Municipals	217,054	1,585	(3,616)	215,023
Total	2,031,068	9,959	(22,529)	2,018,498

At 31 December 2015 – USD '000	Amortised cost	Unrealised gains	Unrealised losses	Fair value
US Treasuries	277,824	2,681	(357)	280,148
Non-US government	58,841	433	–	59,274
Corporate	742,075	1,215	(9,492)	733,798
Agency residential mortgage backed	220,927	1,259	(2,716)	219,470
Commercial mortgage backed	59,629	4	(2,604)	57,029
Asset backed	76,004	–	(382)	75,622
Collateralised debt obligations	165,737	64	(4,453)	161,348
Municipals	89,986	2,271	(29)	92,228
Total	1,691,023	7,927	(20,033)	1,678,917

Of the USD 2,018.5 million available for sale fixed interest securities as at 31 December 2016 (2015 – USD 1,678.9 million), USD 134.9 million (2015 – USD 193.9 million) relates to securities held by the Company for the purpose of funding future claim payments in relation to a loss portfolio transfer agreement ("LPTA"). At 31 December 2016, the securities related to the LPTA consist of non-United States government securities of USD 44.6 million (2015 – USD 59.3 million), corporate securities of USD 88.8 million (2015 – USD 132.9 million) and asset backed securities of USD 1.5 million (2015 – USD 1.7 million). The net unrealised gain on the LPTA securities of USD 1.3 million at the end of the year 2016 (2015 – USD 0.4 million) has been offset against the corresponding liability for collateral held on behalf of counterparties. The LPTA is referred to in Note 12 – Deposit Contracts.

In the normal course of business, available for sale fixed interest securities and cash and cash equivalents with fair value of USD 128.8 million as at 31 December 2016 (2015 – USD 177.1 million), were deposited in trust for the benefit of ceding companies and credit institutions.

7. INVESTMENTS (continued)

(b) Fixed interest securities, available for sale (continued)

(ii) The amortised cost and estimated fair value of available for sale fixed interest securities by contractual maturity, are shown below. Actual maturities may differ from contractual maturities because borrowers may have the right to repay obligations with or without prepayment penalties.

At 31 December 2016 – USD '000	Amortised cost	Fair value
Within one year	204,574	204,702
From one to five years	822,902	821,608
From five to ten years	136,143	135,247
Subtotal	1,163,619	1,161,557
Agency residential mortgage backed	292,213	286,598
Commercial mortgage backed	56,299	52,377
Asset backed	133,968	133,787
Collateralised debt obligations	167,915	169,156
Municipals	217,054	215,023
Total	2,031,068	2,018,498

At 31 December 2015 – USD '000	Amortised cost	Fair value
Within one year	90,628	90,810
From one to five years	822,587	819,730
From five to ten years	165,525	162,680
Subtotal	1,078,740	1,073,220
Agency residential mortgage backed	220,927	219,470
Commercial mortgage backed	59,629	57,029
Asset backed	76,004	75,622
Collateralised debt obligations	165,737	161,348
Municipals	89,986	92,228
Total	1,691,023	1,678,917

(iii) The Company's available for sale fixed interest securities carry a weighted average credit rating of A (2015 – A+) as assigned by Standard & Poor's (S&P).

The rating profile of the Company's available for sale fixed interest securities, based on S&P or equivalent rating, is shown in the table below.

USD '000	2016	2015
AAA	257,180	150,904
AA+, AA, AA-	703,106	644,927
A+, A, A-	416,784	415,744
BBB+, BBB, BBB-	439,435	391,434
Below investment grade	35,580	23,341
Not rated	166,413	52,567
	2,018,498	1,678,917

7. INVESTMENTS (continued)

(c) Investments in catastrophe bonds, available for sale

The Company has one catastrophe bond investment as of 31 December 2016 which is due to mature in 2017. The catastrophe bond has a credit rating of BB- as assigned by Standard and Poor's. The Company held three bonds as of 31 December 2015, two of which matured in 2016. The issuers of these securities have used the proceeds raised to collateralise certain catastrophe reinsurance obligations, mainly North American and European wind and earthquake risks. The investment in these securities is therefore at risk of loss, in whole or in part, if a covered catastrophe occurs.

The cost, fair value and unrealised gains and losses of investments in catastrophe bonds were as follows:

At 31 December 2016 – USD '000	Cost	Unrealised gains	Unrealised losses	Fair value
Catastrophe bonds	3,156	–	(2)	3,154

At 31 December 2015 – USD '000	Cost	Unrealised gains	Unrealised losses	Fair value
Catastrophe bonds	10,280	19	(23)	10,276

Unrealised losses on catastrophe bonds held in 2016 and 2015 comprise an accumulation of unrealised losses on a security by security basis caused by general market movements rather than credit events. As of 31 December 2016 and 2015, the Company had no unrealised losses caused by other factors or circumstances, including issuer specific credit risks or due to exposures to catastrophe events.

(d) Equity securities, available for sale

The acquisition cost, fair value and unrealised gains and losses of investments in available for sale equity securities are as follows:

At 31 December 2016 – USD '000	Acquisition Cost	Unrealised gains	Unrealised losses	Fair value
Common stock	19,806	1,296	(268)	20,834
Mutual funds	10,000	375	–	10,375
Real estate investment trusts	9,204	–	(70)	9,134
Total	39,010	1,671	(338)	40,343

At 31 December 2015 – USD '000	Acquisition Cost	Unrealised gains	Unrealised losses	Fair value
Common stock	18,789	328	(1,302)	17,815
Mutual funds	10,000	–	(734)	9,266
Real estate investment trusts	10,063	–	(1,498)	8,565
Total	38,852	328	(3,534)	35,646

7. INVESTMENTS (continued)

(e) Other securities, at fair value through profit and loss

The acquisition cost, fair value and unrealised gains and losses of investments in other securities at fair value through profit and loss are as follows:

At 31 December 2016 – USD '000	Acquisition Cost	Unrealised gains	Unrealised losses	Fair value
Investments in:				
Limited partnerships	13,212	925	(103)	14,034
Limited liability companies	2,089	188	–	2,277
Total	15,301	1,113	(103)	16,311

At 31 December 2015 – USD '000	Acquisition Cost	Unrealised gains	Unrealised losses	Fair value
Investments in:				
Limited partnerships	12,231	49	(216)	12,064
Limited liability companies	1,250	–	–	1,250
Total	13,481	49	(216)	13,314

(f) Components of investment income

The components of net investment income for the years ended 31 December 2016 and 2015 were as follows:

31 December 2016 – USD '000	Interest and dividends	Net realised gains	Net change in unrealised gains	Impairment losses	Net investment income
Cash and cash equivalents	1,128	–	–	–	1,128
Funds withheld	3,032	–	–	–	3,032
Short term investments	3,496	–	–	–	3,496
Fixed interest securities – AFS	50,878	3,904	–	(32)	54,750
Catastrophe bonds	5	–	–	–	5
Equity securities – AFS	3,106	558	–	(1,214)	2,450
Other securities – FVTPL	–	270	1,176	–	1,446
Sub total	61,645	4,732	1,176	(1,246)	66,307
Investment management fees					(5,435)
Net investment income					60,872

31 December 2015 – USD '000	Interest and dividends	Net realised gains (losses)	Net change in unrealised gains/(losses)	Impairment losses	Net investment income
Cash and cash equivalents	1,086	–	–	–	1,086
Funds withheld	2,143	–	–	–	2,143
Short term investments	3,580	–	–	–	3,580
Fixed interest securities – FVTPL	172	–	84	–	256
Fixed interest securities – AFS	29,011	3,171	–	(209)	31,973
Catastrophe bonds	3	–	–	–	3
Equity securities – AFS	1,471	–	–	(2,289)	(818)
Other securities – FVTPL	–	(307)	(167)	–	(474)
Sub total	37,466	2,864	(83)	(2,498)	37,749
Investment management fees					(2,439)
Net investment income					35,310

8. FAIR VALUE MEASUREMENTS

Fair value measurements are established in accordance with the framework provided by IFRS 13, *Financial Instruments: Disclosures*. IFRS 13 establishes a fair value hierarchy with the highest priority given to quoted prices in active markets and the lowest priority given to unobservable inputs.

The following are the levels within the fair value hierarchy:

- Level 1 – Valuations based on quoted prices in active markets for identical assets or liabilities that the Company has the ability to access. Since valuations are based on quoted prices that are readily and regularly available in an active market, valuation of these instruments does not entail a significant degree of judgment.
- Level 2 – Valuations based on quoted prices in markets that are not active or for which all significant inputs are observable, directly or indirectly. Level 2 inputs include quoted prices for similar assets and liabilities in active markets and inputs other than quoted prices that are observable for the asset or liability, such as interest rates and yield curves that are observable at commonly quoted intervals, broker quotes and certain pricing indices.
- Level 3 – Valuations based on inputs that are unobservable and significant to the overall fair value measurement. These measurements include circumstances where there is little, if any, market activity for the asset or liability. In these cases, significant management assumptions can be used to establish management's best estimate of the assumptions used by other market participants in determining the fair value of the asset or liability.

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the level in the fair value hierarchy within which the fair value measurement in its entirety falls has been determined based on the lowest level input that is significant to the fair value measurement of the asset or liability. The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and the Company considers factors specific to the asset or liability.

Below is a summary of the assets and liabilities that are measured at fair value on a recurring basis:

At 31 December 2016 – USD '000	Total	Quoted prices in active markets for identical assets (Level 1)	Other observable inputs (Level 2)	Unobservable inputs (Level 3)
Financial assets				
Investments				
Short term investments	177,979	177,979	–	–
Fixed interest securities				
US Treasuries	143,364	143,364	–	–
Non-US government	87,857	–	87,857	–
Corporate	930,336	–	770,538	159,798
Agency residential mortgage backed	286,598	–	286,598	–
Commercial mortgage backed	52,377	–	50,180	2,197
Asset backed	133,787	–	133,787	–
Collateralised debt obligations	169,156	–	169,156	–
Municipals	215,023	–	213,060	1,963
Investments in catastrophe bonds	3,154	–	3,154	–
Equity securities	40,343	29,968	–	10,375
Other securities	16,311	–	–	16,311
Sub total	2,256,285	351,311	1,714,330	190,644
Derivative assets	3,960	–	–	3,960
Total	2,260,245	351,311	1,714,330	194,604
Financial liabilities				
Derivative liabilities	(4,008)	–	–	(4,008)
Total	2,256,237	351,311	1,714,330	190,596

8. FAIR VALUE MEASUREMENTS (continued)

At 31 December 2015 – USD '000	Total	Quoted prices in active markets for identical assets (Level 1)	Other observable inputs (Level 2)	Unobservable inputs (Level 3)
Financial assets				
Investments				
Short term investments	255,624	255,624	–	–
Fixed interest securities				
US Treasuries	280,148	280,148	–	–
Non-US government	59,274	59,274	–	–
Corporate	733,798	–	698,795	35,003
Agency residential mortgage backed	219,470	–	219,470	–
Commercial mortgage backed	57,029	–	46,198	10,831
Asset backed	75,622	–	75,622	–
Collateralised debt obligations	161,348	–	123,503	37,845
Municipals	92,228	–	92,228	–
Investments in catastrophe bonds	10,276	–	10,276	–
Equity securities	35,646	26,380	–	9,266
Other securities	13,314	–	–	13,314
Sub total	1,993,777	621,426	1,266,092	106,259
Derivative assets	4,773	–	–	4,773
Total	1,998,550	621,426	1,266,092	111,032
Financial liabilities				
Derivative liabilities	(4,307)	–	–	(4,307)
Total	1,994,243	621,426	1,266,092	106,725

The Company elected to classify certain non-United States government securities within Level 2 in 2016, which were previously within Level 1. While these securities may qualify for Level 1 classification based on ordinary transactions in identical instruments, it has been assumed, as a practical expedient, that such instruments would predominantly be valued based on a mix of observable inputs.

There were no transfers made between Levels 1, 2 and 3 of the fair value hierarchy in 2015.

Short term investments
Short term investments, which comprise securities due to mature within one year of the date of purchase, that are traded in active markets are classified within Level 1 as fair values are based on quoted market prices.

Fixed interest securities
Fixed interest securities are priced using pricing services, such as index providers and pricing vendors. The pricing vendors provide pricing for a high volume of liquid securities that are actively traded. For securities that do not trade on an exchange, the pricing services generally utilise market data and other observable inputs in pricing models to determine prices. Prices are generally verified using third party data. The techniques generally used to determine the fair value of our fixed interest securities are detailed below by asset class.

US Treasuries

These securities are primarily priced by pricing vendors. When pricing these securities, the vendor may utilise daily data from many real time market sources, including active trades, as such, the Company considers its United States Treasury fixed interest securities as Level 1.

8. FAIR VALUE MEASUREMENTS (continued)

Non-US government

Fixed interest securities included in non-United States government are primarily priced by pricing vendors. When evaluating these securities, the vendor may gather information from market sources and integrate other observations from markets and sector news. Evaluations are updated by obtaining broker dealer quotes and other market information including actual trades, when available. For securities in which trade volume is relatively high, the vendor may utilise data from active trades, as such, these are included as Level 1. For securities in which trade volume is low, the pricing vendor may also utilise data from more frequently traded securities with similar attributes. These are considered observable inputs therefore, the fair value of such securities are classified as Level 2.

Corporate

Corporate securities primarily include fixed rate corporate bonds and floating rate notes. The Company's corporate fixed interest securities are primarily priced by pricing vendors. When evaluating these securities, the vendor may gather information from market sources regarding the issuer of the security, obtain credit data, as well as other observations from markets and sector news. Evaluations are updated by obtaining broker dealer quotes and other market information including actual trades, when available. The pricing vendor may also consider the specific terms and conditions of the securities, including any specific features which may influence risk. These are considered observable inputs therefore, the fair value of such securities are classified as Level 2.

The Company's corporate securities also include private placements and mortgage loans, for which there is limited observable input on which to measure fair value, which are classified as Level 3. The fair value of these private placements is estimated to be equal to its amortised cost.

Residential ("RMBS") and commercial mortgage backed ("CMBS") securities

The vendor uses various valuation techniques and pricing models to measure the fair value of its investments in RMBS and CMBS, including option adjusted spread models, volatility driven multi dimensional single cash flow stream models and matrix correlation to comparable securities. RMBS include United States agency securities and collateralised mortgage obligations. Inputs utilised in connection with the valuation techniques include monthly payment and performance information, including prepayments, default severity, delinquencies, market indices and the amounts of the tranches in the particular structure which are senior or subordinate, as applicable, to the tranche represented by the Company's investment. Valuations may also be corroborated by daily active market quotes. As of 31 December 2016, 99% (2015 – 96%) of the Company's investment in mortgage backed securities are valued using observable inputs and therefore are categorised as Level 2 of the fair value hierarchy. The remaining mortgage backed securities are valued using non-binding broker quotes which rely on unobservable inputs and thus these securities are categorised as Level 3 of the fair value hierarchy.

Asset backed

The underlying collateral for the Company's asset backed fixed interest securities primarily consists of automobile and credit card loans. Securities held in this sector are primarily priced by pricing vendors and are considered as Level 2 by the Company as inputs are observable. The pricing vendor may apply dealer quotes and other available trade information such as bid and offers, prepayment spreads which may be adjusted for the underlying collateral or current price data, the United States Treasury curve, swap curve and TBA values as well as cash settlement.

Collateralised debt obligations

Collateralised debt obligations consist of collateralised loans. The pricing vendor's valuation techniques utilise non-binding broker quotes as the key input for a majority of the portfolio. As such inputs are generally unobservable, these collateralised debt obligations are categorised as Level 3 of the fair value hierarchy. For the remaining securities, valuation is determined utilising observable inputs including monthly payment information, prepayment data, default severity and delinquencies. These securities are categorised as Level 2 of the fair value hierarchy.

Municipals

These include bonds or notes issued by United States municipalities. Inputs utilised include recently executed transactions and other market data, spreads, benchmark curves including treasury and other benchmarks, trustee reports, material event notices, new issue data, and issuer financial statements. These inputs are generally observable and as such, these securities are categorised as Level 2 of the fair value hierarchy. The remaining securities are valued using non binding broker quotes which rely on unobservable inputs and thus these securities are categorised as Level 3 of the fair value hierarchy.

Investments in catastrophe bonds
Investments in catastrophe bonds are recorded at fair value based on quoted market prices, or when such prices are not available, by reference to published broker or underwriter bid and offer indications. As such, the Company considers its investments in catastrophe bonds as Level 2.

Equity securities
This is comprised of common stock, mutual funds, and real estate investment trusts. Equities are generally included as Level 1 in the fair value hierarchy as prices are obtained from market exchanges in active markets. Investments in mutual funds, where the fair value of the fund is estimated to be the net asset value reported by the fund administrator at the balance sheet date, are classified as Level 3.

8. FAIR VALUE MEASUREMENTS (continued)

Other securities

Other securities consist of investments in investment funds organised as limited partnerships, investment in funds organised as limited liability companies, real estate investments held by limited liability companies and trading account securities.

For private equity investments, since quoted market prices are not available, the transaction price is used as the best estimate of fair value at inception. When evidence is believed to support a change to the carrying value from the transaction price, adjustments are made to reflect expected exit values. Ongoing valuation reviews are based on assessments of each underlying investment and the inputs utilised in these reviews include, among other things, the evaluation of financing and sale transactions with third parties, expected cashflows, material events and market based information. These investments are categorised as Level 3 of the fair value hierarchy.

For investments in funds organised as limited liability companies, the funds' financial statements constitute the key valuation input. The value calculated using the equity method of accounting with respect to the investment in this limited liability company was reflective of the fair market value of such investments, and therefore such investments are categorised as Level 3 of the fair value hierarchy.

Fair value of derivative assets and liabilities

Included in Level 3 are the Company's catastrophe swap derivatives. Catastrophe swap derivatives are stated at fair value as estimated by management primarily based on the unexpired period of risk, an evaluation of the probability of loss and other unobservable inputs. The Company's catastrophe swap derivatives are initially priced at fair value in a non stressed market and amortisation reflects the change in fair value in the absence of any loss events. The fair value of derivative contracts is sensitive to loss triggering events. In the event of a loss, the Company would adjust the fair value of the derivative to account for a recovery or liability in accordance with the contract terms and the estimate of exposure under the contract. The inputs for catastrophe swap derivatives are based on management's evaluation and are unobservable.

The following tables provide reconciliations for Level 3 assets measured at fair value on a recurring basis for the years ended 31 December 2016 and 2015:

At 31 December 2016 USD '000	2015	Net gains (losses) included in earnings	Net gains (losses) included in other comprehensive income	Purchases	Sales	Transfers out of Level 3	2016
Financial assets							
Corporate	35,003	586	–	159,552	(35,343)	–	159,798
Commercial mortgage backed	10,831	311	351	1,895	(11,191)	–	2,197
Collateralised debt obligations	37,845	154	1,046	–	–	(39,045)	–
Municipals	–	–	(37)	2,000	–	–	1,963
Equity securities	9,266	–	1,109	–	–	–	10,375
Other securities	13,314	1,241	–	2,593	(837)	–	16,311
Derivative assets	4,773	(29,844)	–	29,031	–	–	3,960
Sub total	111,032	(27,552)	2,469	195,071	(47,371)	(39,045)	194,604
Financial liabilities							
Derivative liabilities	(4,307)	32,082	–	–	(31,783)	–	(4,008)
Total	106,725	4,530	2,469	195,071	(79,154)	(39,045)	190,596

The Company transferred certain collateral debt obligations from Level 3 into Level 2 in 2016, as the valuation is now determined utilising observable inputs for these securities.

8. FAIR VALUE MEASUREMENTS (continued)

At 31 December 2015 USD '000	2014	Net gains (losses) included in earnings	Net unrealised (losses) included in other comprehensive income	Purchases	Sales	2015
Financial assets						
Corporate	–	50	–	34,953	–	35,003
Commercial mortgage backed	–	65	(137)	10,903	–	10,831
Collateralised debt obligations	–	40	4	37,801	–	37,845
Equity securities	–	–	(734)	10,000	–	9,266
Other securities	–	(231)	–	13,545	–	13,314
Derivative assets	1,806	(13,446)	–	16,413	–	4,773
Sub total	1,806	(13,522)	(867)	123,615	–	111,032
Financial liabilities						
Derivative liabilities	(2,550)	22,201	–	–	(23,958)	(4,307)
Total	(744)	8,679	(867)	123,615	(23,958)	106,725

Net gains (losses) on investments and on derivative assets and liabilities are included in net investment income and net derivative income, respectively, in the consolidated statement of comprehensive income.

Investments included in Level 3
At 31 December 2016, investments included in Level 3 amounted to USD 190.6 million (2015 – USD 106.3 million).

If models are used to measure financial assets and liabilities included in level 3 under which the adoption of alternative inputs lead to a material change in fair value, IFRS 13 requires disclosure of the effects of these alternative assumptions.

Equity securities and other securities classified as Level 3 are mainly priced based on the (adjusted) net asset value method. The key unobservable input is net asset value which is provided by the respective fund manager. Since the Company has limited insight into the specific inputs used by the fund managers in estimating fair value, the effects of using alternative inputs within the meaning of IFRS 13 cannot be reasonably established.

Mortgage loans and private placements are valued at an amortised cost, which reasonably approximate fair value for these securities. The key unobservable input for fair value measurement would be a risk adjusted interest rate benchmark (market interest rate for the same tenor and the respective credit risk). The application of alternative inputs and assumptions has no material effect on the consolidated financial statements.

Commercial mortgage backed securities and collateralised debt obligations classified as Level 3 are mainly priced based on the income approach by brokers and traders. The primary unobservable input used in the discounted cash flow method is a risk adjusted interest rate benchmark. A significant yield increase of this benchmark in isolation could result in a decreased fair value, while a significant yield decrease could result in an increased fair value. However, a simplified 10% stress of this main non-market observable input has no material impact to the fair value as at 31 December 2016.

Derivative assets and liabilities included in Level 3
At 31 December 2016, derivative assets comprise unearned derivative expense of USD 4.0 million (2015 – USD 4.8 million).

At 31 December 2016, derivative liabilities comprise unearned derivative income of USD 4.0 million (2015 – USD 4.3 million).

The following methods and assumptions are used by the Company in estimating fair value disclosures for other financial instruments:

Cash and cash equivalents, Short term investments and Liability for collateral held on behalf of counterparties.
The carrying amounts reported in the consolidated balance sheet for these instruments approximate their fair values.

8. FAIR VALUE MEASUREMENTS (continued)

Other assets and liabilities

The fair value of funds withheld, accrued interest receivable, premiums receivable, deposit assets, other assets, reinsurance balances payable, deposit liabilities, payable for investments purchased, accounts payable, and accrued expenses and note payable approximates their carrying value due to their short term nature in general. The estimates of fair values are subjective in nature and are not necessarily indicative of the amounts that the Company would actually realise in a current market exchange. However, any differences would not be expected to be material. Certain instruments such as prepaid reinsurance premiums, outstanding losses recoverable from reinsurers, deferred acquisition expenses, unearned profit commission, property and equipment, intangible assets, other assets, outstanding losses and loss expenses, unearned premiums, deferred commission income and deferred fee income are excluded from fair value disclosure.

Thus, the total fair value amounts cannot be aggregated to determine the underlying economic value of the Company.

9. NET DERIVATIVE INCOME

Net derivative income consists of catastrophe swap derivative premiums earned of USD 2.2 million (2015 – USD 8.8 million) offset by payments made under the Company's catastrophe swap derivatives of USD nil (2015 – USD 0.1 million).

As discussed in Note 4 under 'Credit Risk', the Company's maximum exposure to unrated counterparties is fully collateralised.

10. COLLATERAL HELD ON BEHALF OF COUNTERPARTIES

Collateral received in the form of cash, which is not legally segregated from the Company, is recognised as an asset in the consolidated balance sheet with a corresponding liability for the repayment. In addition, amounts arising from the application of the deposit method of accounting to ceded retrocession or reinsurance contracts are included.

11. REINSURANCE AND OTHER ASSETS

USD '000	2016	2015
Premiums receivable	856,770	716,399
Deposit assets	393,823	296,177
Accrued interest receivable	14,151	12,035
Outstanding losses recoverable from reinsurers	64,975	52,730
Other assets	15,032	20,623
	1,344,751	1,097,964

The current and non-current portions are expected to be as follows:

USD '000	2016	2015
Current portion	852,256	698,987
Non-current portion	492,495	398,977
	1,344,751	1,097,964

The Company assesses its reinsurance receivables for impairment on a quarterly basis by reviewing counterparty payment history. The carrying amounts disclosed above reasonably approximate the fair value at the reporting date.

12. DEPOSIT CONTRACTS

Effective 1 July 2014, Tokio Millennium Re AG – Bermuda Branch ("TMRB") entered into a loss portfolio transfer agreement ("first LPTA"). TMRB accepted, on a fully collateralised basis, the liability of a loss portfolio with an aggregate limit capped at EUR 366.0 million. Through a quota share retrocession agreement, TMRB retroceded 100% of its liability to another party. TMRB is compensated through a ceding commission as a percentage of the initial aggregate limit, which is earned from the first LPTA effective date to expected contract termination date. The collateral for the first LPTA consists of short term investments and available for sale fixed interest securities which are included in the Company's consolidated balance sheet. These are referred to in Note 7 – Investments.

Effective 30 June 2016, TMRB entered into three loss portfolio transfer agreements ("second LPTA"). TMRB accepted, on a fully collateralised basis, the liability of a loss portfolio with an aggregate limit capped at GBP 202.8 million. Through three retrocession agreements, TMRB retroceded 100% of its liability to another party. TMRB is compensated through a ceding commission as a percentage of the initial aggregate limit, which is earned from the second LPTA effective date to expected contract termination date. The collateral assets for the second LPTA are held in trusts by the counterparty for the benefit of the Company. For consolidation purposes, it was determined that the Company does not have sufficient control over the assets held in the trust accounts, therefore these assets are not included in the consolidated balance sheet. The trust accounts had a total cash balance of USD 248.0 million as of 31 December 2016.

13. DEFERRED ACQUISITION EXPENSES AND DEFERRED COMMISSION INCOME

The reconciliation of opening and closing deferred acquisition costs incurred and ceded is as follows:

	2016				2015			
USD '000	Gross	Ceded	Other	Net	Gross	Ceded	Other	Net
At 1 January	327,938	(3,511)	(1,199)	323,228	201,528	(2,840)	(702)	197,986
Expense deferred	385,099	(31,892)	(4,084)	349,123	403,393	(22,234)	(927)	380,232
Amortisation	(340,995)	25,604	1,054	(314,337)	(273,487)	21,511	430	(251,546)
Other	(12,208)	3,734	–	(8,474)	(3,496)	52	–	(3,444)
At 31 December	359,834	(6,065)	(4,229)	349,540	327,938	(3,511)	(1,199)	323,228

The current and non-current portions are expected to be as follows:

USD '000	2016	2015
Current portion	236,970	214,364
Non-current portion	112,570	108,864
	349,540	323,228

14. TAXATION

The Swiss operation is subject to Swiss cantonal and federal taxes of 21.15% (2015: 21.15%). The Company has branches that operate in Australia, United States and the United Kingdom which are subject to income taxes at statutory rates of 30%, 35%, and 20%, respectively.

The Company has subsidiaries and a branch in Bermuda which are not subject to income or capital gains tax under the current Bermuda law. In the event there is a change in current law such that income or capital gains are imposed, the Company would be exempt from such tax until March 2035 pursuant to the Bermuda Exempted Undertakings Tax Protection Act of 1966.

14. TAXATION (continued)

Income tax

The Swiss standard rate of tax is 21.15% (2015: 21.15%), whereas the tax charges for the year ended 31 December 2016 as a percentage of profit before tax is 2.24% (2015: 1.14%). The reasons for this difference are explained below:

USD '000	2016	2015
Profit before tax	123,442	109,050
Tax calculated at the standard corporation tax rate applicable in Switzerland: 21.15% (2015: 21.15%)	26,108	23,064
Non-taxable income	(24,286)	(22,731)
Tax rate differences on foreign branches	652	784
Deferred tax adjustment in respect of prior years	686	–
Tax rate change adjustment	108	–
Tax losses for which no deferred tax asset is recognised	–	1,013
Utilisation of tax losses previously unrecognised for deferred tax	(892)	(1,644)
Other	394	752
Actual expense for income tax	2,770	1,238

The following table presents the major components of the income tax expense:

USD '000	2016	2015
Corporation tax charge for the year	2,513	(2)
Adjustments in respect of prior year corporation tax	(70)	–
Deferred tax (credit) charge for the year	(637)	1,234
Adjustments in respect of prior year deferred tax	856	6
Tax rate change adjustment	108	–
Total tax charge	2,770	1,238

Deferred tax

USD '000	2016	2015
Deferred tax asset	2,183	3,021
Deferred tax liability	(129)	(706)
Total net deferred tax asset	2,054	2,315

The Company's deferred tax asset results from an operating loss carry forward and IFRS versus tax basis accounting differences. The deferred tax asset of USD 2.2 million at 31 December 2016 (2015: USD 3.0 million) has been recognised as the Company expects the business to produce taxable profits in future periods against which the tax losses can be offset. A deferred tax asset of USD 0.7 million was written down to nil in 2016 (2015 – USD nil) for tax benefits which management determined will not be realised against future taxable profits.

In accordance with IAS 12, *Income Taxes*, to avoid the need for detailed scheduling of the timing of the reversal of each temporary difference, TMR AG has offset its deferred tax asset against its deferred tax liability, as they relate to the same taxable entities and relate to income taxes levied by the same taxation authorities.

14. TAXATION (continued)

Deferred tax (continued)

Net deferred tax assets analysed by balance sheet headings and after appropriate netting are as follows:

At 31 December – USD '000	2015	Income statement (charge)/credit	Transfer from equity	Foreign currency translation	2016
Outstanding losses and loss expenses	2,570	2,417	–	(6)	4,981
Unearned premiums	31,055	6,718	–	–	37,773
Deferred acquisition expenses	697	202	–	(15)	884
Accounts payable and accrued expenses	1,522	276	–	(2)	1,796
Operating losses	29,248	53	–	(257)	29,044
Retirement benefit obligation	92	(14)	–	(3)	75
Other	1,086	532	–	(71)	1,547
Total deferred tax assets	66,270	10,184	–	(354)	76,100
Investment assets	(263)	(236)	230	7	(262)
Premiums receivable	(352)	(30)	–	15	(367)
Outstanding losses and loss expenses	(4,476)	(635)	–	163	(4,948)
Deferred acquisition expenses	(58,864)	(9,495)	–	–	(68,359)
Other	–	(115)	–	5	(110)
Total deferred tax liabilities	(63,955)	(10,511)	230	190	(74,046)
Net deferred tax assets	2,315	(327)	230	(164)	2,054

15. PROPERTY AND EQUIPMENT

Property and equipment at 31 December 2016 comprise:

USD '000	Computer equipment	Fixtures and fittings	Leasehold improvements	Motor vehicles	Office equipment	Total
Cost						
At 1 January 2016	10,246	3,572	13,208	127	20	27,173
Additions	418	17	86	–	–	521
Disposals	–	–	(161)	–	–	(161)
At 31 December 2016	10,664	3,589	13,133	127	20	27,533
Accumulated depreciation						
At 1 January 2016	8,354	2,263	4,596	103	17	15,333
Charge for the year	1,232	335	1,130	9	1	2,707
Disposals	–	–	(80)	–	–	(80)
At 31 December 2016	9,586	2,598	5,646	112	18	17,960
Net book value						
At 31 December 2016	1,078	991	7,487	15	2	9,573
At 1 January 2016	1,892	1,309	8,612	24	3	11,840

15. PROPERTY AND EQUIPMENT (continued)

Property and equipment at 31 December 2015 comprise:

USD '000	Computer equipment	Fixtures and fittings	Leasehold improvements	Motor vehicles	Office equipment	Total
Cost						
At 1 January 2015	9,546	3,364	14,203	127	20	27,260
Additions	700	208	1,783	–	–	2,691
Disposals	–	–	(2,778)	–	–	(2,778)
At 31 December 2015	10,246	3,572	13,208	127	20	27,173
Accumulated depreciation						
At 1 January 2015	6,947	1,854	4,580	93	17	13,491
Charge for the year	1,407	409	2,171	10	–	3,997
Disposals	–	–	(2,155)	–	–	(2,155)
At 31 December 2015	8,354	2,263	4,596	103	17	15,333
Net book value						
At 31 December 2015	1,892	1,309	8,612	24	3	11,840
At 1 January 2015	2,599	1,510	9,623	34	3	13,769

16. INTANGIBLE ASSETS

Intangible assets at 31 December 2016 comprise:

USD '000	Computer software
Cost	
At 1 January 2016	33,958
Additions	5,711
Disposals	–
At 31 December 2016	39,669
Accumulated amortisation	
At 1 January 2016	25,529
Charge for the year	4,978
Disposals	–
At 31 December 2016	30,507
Net book value	
At 31 December 2016	9,162
At 1 January 2016	8,429

Intangible assets at 31 December 2015 comprise:

USD '000	Computer software
Cost	
At 1 January 2015	28,660
Additions	5,298
Disposals	–
At 31 December 2015	33,958
Accumulated amortisation	
At 1 January 2015	21,470
Charge for the year	4,059
Disposals	–
At 31 December 2015	25,529
Net book value	
At 31 December 2015	8,429
At 1 January 2015	7,190

17. INSURANCE LIABILITIES

(a) Outstanding losses and loss expenses and losses recoverable from reinsurers

The summary of changes in outstanding losses and loss expenses is as follows:

USD '000	Outstanding losses and loss expenses	Outstanding losses recoverable from reinsurers	Net
At 31 December 2014	699,305	(51,473)	647,832
Incurred losses related to:			
Current year	523,014	(6,981)	516,033
Prior years	(13,500)	4,897	(8,603)
Adverse development cover	–	1,632	1,632
Loss portfolio transfer	36,393	–	36,393
Net effect of foreign currency exchange rate changes	(26,091)	838	(25,253)
Total incurred	519,816	386	520,202
Paid losses related to:			
Current year	147,670	(1,063)	146,607
Prior years	213,751	2,706	216,457
Total paid	361,421	1,643	363,064
At 31 December 2015	857,700	(52,730)	804,970
Incurred losses related to:			
Current year	741,684	(29,640)	712,044
Prior years	(44,647)	(857)	(45,504)
Adverse development cover	–	9,592	9,592
Loss portfolio transfer	7,583	–	7,583
Net effect of foreign currency exchange rate changes	(3,539)	202	(3,337)
Total incurred	701,081	(20,703)	680,378
Paid losses related to:			
Current year	202,362	(8,288)	194,074
Prior years	241,760	(170)	241,590
Total paid	444,122	(8,458)	435,664
At 31 December 2016	1,114,659	(64,975)	1,049,684

The current and non current portions of the outstanding losses and loss expenses are expected to be as follows:

2016 – USD '000	Outstanding losses and loss expenses	Outstanding losses recoverable from reinsurers	Net
Current	300,018	(19,831)	280,187
Non-current	814,641	(45,144)	769,497
	1,114,659	(64,975)	1,049,684

2015 – USD '000	Outstanding losses and loss expenses	Outstanding losses recoverable from reinsurers	Net
Current	259,398	(30,485)	228,913
Non-current	598,302	(22,245)	576,057
	857,700	(52,730)	804,970

17. INSURANCE LIABILITIES (continued)

(a) Outstanding losses and loss expenses and losses recoverable from reinsurers (continued)

During 2016, the Company incurred net losses of USD 666.5 million (2015 – USD 507.4 million), which mostly relate to attritional losses on proportional and non catastrophe excess of loss property and casualty contracts. Furthermore, USD 19.3 million was related to losses from Hurricane Matthew in October 2016 and USD 6.3 million on a hailstorm event in the Netherlands in June 2016.

The Company experienced a net favourable development of USD 45.5 million (2015 – USD 8.6 million) attributable to prior years, which mostly relate to development on attritional losses on proportional and non catastrophe excess of loss property and casualty contracts.

During 2015, the Company incurred net losses of USD 507.4 million, which mostly relate to attritional losses on proportional and non catastrophe excess of loss property and casualty contracts, as well as loss development from prior years. In addition, USD 8.5 million was related to the New South Wales East Coast Low event in April 2015 and another USD 2.1 million on windstorm events which impacted Texas in 2015. A USD 16.6 million adverse development on a 2012 quota share deal was also recorded in 2015.

For certain catastrophic events, there is considerable uncertainty underlying the assumptions and associated estimated reserves for losses and loss adjustment expenses. Reserves are reviewed regularly and, as experience develops and new information becomes known, the reserves are adjusted as necessary. Such adjustments could require a material change in the amount estimated. The uncertainty surrounding reserves for property catastrophe exposures arises from problems such as policy coverage issues, multiple events affecting one geographic area and the impact on claims adjusting by ceding companies. These issues can cause significant delays to the timing of notification of changes to loss estimates reported by ceding companies. In particular, the estimates for the New Zealand earthquakes have been based on a review of contracts affected by the events, information received from both clients and brokers, industry insured loss estimates, the output from both industry and proprietary models and management judgment. It has also been assumed that underlying policy terms and conditions are upheld during the loss adjustment process. There remains the potential for legal and regulatory issues arising regarding the scope of coverage. Consequently, the ultimate net impact of losses from these events on the Company's net income might differ substantially from the foregoing estimate. Such adjustments, if necessary, are reflected in results of operations in the period in which they become known.

(b) Unearned premiums

The current and non-current portions of the unearned premiums are expected to be as follows:

USD '000	2016	2015
Current portion	852,499	714,157
Non-current portion	384,552	369,190
	1,237,051	1,083,347

18. REINSURANCE AND OTHER LIABILITIES

USD '000	2016	2015
Outstanding losses and loss expenses	1,114,659	857,700
Liability for collateral held on behalf of counterparties	185,536	233,617
Reinsurance balances payable	93,162	89,107
Deposit liabilities	393,823	296,177
Payable for investments purchased	7,947	8,748
Fair value of derivative liabilities	4,008	4,307
Accounts payable and accrued expenses	35,966	36,565
Note payable	25,000	25,000
	1,860,101	1,551,221

The current and non-current portions are expected to be as follows:

USD '000	2016	2015
Current portion	574,043	514,134
Non-current portion	1,286,058	1,037,087
	1,860,101	1,551,221

19. NOTE PAYABLE

The Company issued a private catastrophe bond ("Omamori") using a segregated account of Shima Re which provides TMR AG with a source of fully collateralised second event retrocessional reinsurance protection against United States earthquakes and named storms. The Omamori catastrophe bond is a three year deal which incepted on 17 January 2014. The transaction was facilitated by TSM as insurance manager of Shima Re. In accordance with IFRS 10, *Consolidated Financial Statements*, as TMR AG has control over the Omamori segregated account, it has been consolidated with the Company's financial statements. As a result of this transaction, a note payable of USD 25.0 million at 31 December 2016 (2015: USD 25.0 million) has been recorded in the consolidated balance sheet. It pays a 5% annual coupon rate to noteholders and as such, related interest expense and payable are recorded in the consolidated financial statements.

20. RETIREMENT BENEFIT OBLIGATION

(a) Defined benefit scheme

The Company's Switzerland operation offers a defined benefit pension plan to its employees. The plan offers mandatory benefits as prescribed by the Law on Occupational Benefits in Switzerland as well as voluntary benefits. These mandatory benefits comprise guarantees regarding the level of interest paid annually on accrued pension savings as well how the rates on these accrued savings are converted into a pension payment at the time of retirement. The Company and the members contribute a defined percentage of salary to the pension arrangement. Credit accumulation is granted on these contributions. At retirement, the accumulated contributions are converted into a pension. The liability shown relates solely to active members and disability pensioners since the responsibility for meeting old age pensions in payment is irrevocably transferred to an insurance company. Independent actuarial reviews of the ongoing benefit obligations were undertaken at 31 December 2016.

The principal assumptions used for the purposes of the actuarial valuations were as follows:

	2016 % pa	2015 % pa
Discount rate	0.70	0.90
Expected rate of salary increase	2.60	2.60
Interest credit rate	1.00	1.25
Demographic assumptions	BVG2015GT	BVG2010GT

The table below shows the impact on the defined benefit obligation that a change in certain key assumptions would have:

Assumption change	Defined benefit obligation USD
(Increase)/decrease in discount rate by 0.25%	(16,763)/18,277
(Decrease)/increase in salary by 0.25%	(17,354)/17,609

Amounts recognised in the consolidated statement of comprehensive income in respect of the defined benefit scheme are as follows:

USD '000	2016	2015
Current service cost	1,355	1,072
Interest cost	149	174
Interest on plan assets	(125)	(137)
Past service cost	(584)	(254)
Administration costs	32	31
	827	886

The amount included in the consolidated balance sheet arising from the Company's obligations with respect to its defined benefit scheme is as follows:

USD '000	2016	2015
Present value of defined benefit obligations	17,460	16,759
Fair value of plan assets	(12,963)	(13,475)
Retirement benefit obligation	4,497	3,284

20. RETIREMENT BENEFIT OBLIGATIONS (continued)

(a) Defined benefit scheme (continued)

Movements in the present value of the defined benefit obligation during the year are as follows:

USD '000	2016	2015
At 1 January	16,759	11,997
Current service cost	1,355	1,072
Interest cost	149	174
Contributions from plan participants	386	318
Actuarial loss	1,341	692
Net transfers	(1,385)	2,890
Past service cost	(587)	(254)
Foreign currency translation adjustment	(558)	(130)
At 31 December	17,460	16,759

There were no actuarial gains or losses from changes in demographic assumptions. The actuarial loss in 2016 is primarily driven by the change in financial assumptions.

The average duration of the defined benefit obligations was 19.1 years in 2016 (2015 – 17.4 years).

Movements in the fair value of plan assets during the year are as follows:

USD '000	2016	2015
Opening fair value of plan assets	13,475	9,123
Interest income on plan assets	125	137
Actuarial (loss)/gain	(89)	300
Contributions from plan participants	386	318
Employer contributions	893	855
Net transfers	(1,385)	2,890
Administration costs	(32)	(31)
Foreign currency translation adjustment	(410)	(117)
Closing fair value of plan assets	12,963	13,475

The analysis of the plan assets and the expected rate of return by asset class are not provided for the defined benefit scheme as the investment decisions are at the discretion of third parties to whom the Company has ceded investment risk under the insurance policies taken out to meet its obligations.

The Company expects to make a contribution of USD 0.8 million (2015 – USD 0.9 million) to the defined benefit scheme during the next financial year.

(b) Defined contribution plans

The Company operates defined contribution plans in the Bermuda, Australia, and United Kingdom Branches. The total contributions for the year ended 31 December 2016 amounted to USD 1.9 million (2015 – USD 1.6 million).

The Company also maintains a defined contribution plan for employees of its United States Branch in accordance with Section 401(k) of the Internal Revenue Code. The total contribution for the year ended 31 December 2016 amounted to USD 0.2 million (2015 – USD 0.2 million).

21. SHARE CAPITAL

USD '000	2016	2015
Authorised, issued and fully paid, shares of CHF 0.91 (USD 1) par value each	250,000	250,000
Contributed surplus	400,000	400,000

Fully paid issued shares, which have a par value of CHF 0.91 (USD 1) each, carry one vote per share and carry a right to dividends.

Contributed surplus represents cash contributed by the shareholder in excess of the issued share capital.

22. CEDED REINSURANCE

The Company uses retrocessional agreements to reduce its exposure to risk of loss on reinsurance assumed. These agreements generally provide for recovery of a portion of losses and loss expenses from retrocessionaires. The Company remains liable to its cedants to the extent that the retrocessionaires do not meet their obligations under these agreements. Failure of reinsurers to honour their obligations could result in losses to the Company. The Company defines rated reinsurers as companies with a minimum S&P rating of A+ or A.M. Best rating of A and net assets of more than USD 500 million. The Company evaluates the financial condition of its rated reinsurers and monitors the concentration of credit risk, on an ongoing basis, arising from similar geographic regions, activities, or economic characteristics of the reinsurers in order to minimise its exposure to significant losses from rated reinsurer insolvencies. Provisions are made for amounts considered potentially uncollectible.

The Company generally requires non-rated reinsurers to fully collateralise their reinsurance obligations. As further discussed in Note 4 under 'Credit Risk', the Company's maximum exposure to unrated reinsurers is fully collateralised.

In addition to purchasing retrocessional cover, the Company also uses derivative instruments to cover certain assumed reinsurance risks. Refer to Note 2 and Note 8.

23. ACQUISITION EXPENSES

USD '000	2016	2015
Acquisition expenses	353,206	381,159
Change in deferred acquisition expenses	(38,869)	(129,613)
	314,337	251,546

24. GENERAL AND ADMINISTRATIVE EXPENSES

General and administrative expenses consist of the following:

USD '000	2016	2015
Employee benefit expenses	58,595	56,917
Depreciation of property and equipment	2,707	3,997
Amortisation of intangible assets	4,978	4,059
Operating lease charges	3,462	4,557
Other expenses	38,874	36,828
Total	108,616	106,358

25. EMPLOYEE BENEFIT EXPENSES

USD '000	2016	2015
Wages and salaries	35,149	32,021
Long term incentive compensation plan	2,355	5,361
Retirement benefit obligation costs – defined benefit scheme	827	886
Retirement benefit obligation costs – defined contribution scheme	2,121	1,855
Bonus and other benefits	18,143	16,794
	58,595	56,917

26. COMMITMENTS

(a) The Company leases office space under operating leases which expire at various dates. The Company renews and enters into new leases in the ordinary course of business as required. Total rent expense with respect to these operating leases for the year ended 31 December 2016 was USD 3.5 million (2015 – USD 4.6 million).

Future minimum lease payments under the leases are expected to be as follows:

Year – USD '000	
2017	2,896
2018	2,773
2019	2,774
2020	2,107
2021	1,416
Later	68
Total	12,034

(b) The above lease agreements also include a maintenance commitment. Maintenance expense for the current year amounts to USD 0.6 million (2015 – USD 0.9 million) which has been included in general and administrative expenses.

(c) Some lease agreements for office space provide an option to extend the lease beyond the expiration date.

(d) Effective 6 August 2010, the Company entered into a Revolving Letter of Credit Facility Agreement ("Barclays Facility") with Barclays Bank PLC ("Barclays Bank"). The Barclays Facility provided commitments from Barclays Bank in an aggregate amount of USD 100.0 million and provided for the issuance and renewal of letters of credit which are used to support the Company's reinsurance obligations.

The Barclays Facility was amended effective 12 September 2014. Under the terms of the amended agreement, the USD 100.0 million commitment remained unchanged and the commitment termination date was extended to 12 September 2017. Under the terms of the amended agreement, letters of credit can now be issued in alternative currencies other than United States Dollars. However, another amendment was made effective 23 June 2016 which excludes the Australian Dollar currency from the alternative currencies.

Under the Barclays Facility, the Company is required to pledge cash or eligible securities with collateral value (as determined as therein provided) that equals or exceeds 100% of the aggregate amount of its outstanding letters of credit.

The unutilised portion of the Barclays Facility may be cancelled in whole or in part (if in part, in minimum amounts of USD 0.5 million) by the Company without penalty upon due written notice of not less than five business days to Barclays Bank. Amounts so cancelled may not be reinstated. The Barclays Facility contains representations, warranties, and covenants customary for facilities of this type. In addition to the customary covenants, the Company is required to promptly notify Barclays Bank on becoming aware of any negative change in outlook or downgrade in its current rating by any rating agency.

At 31 December 2016, Barclays Bank has issued letters of credit of USD 0.7 million (2015 – USD 13.5 million) in favour of ceding companies under the Barclays Facility. The Company pledged as security USD 16.7 million (2015 – USD 20.8 million) of fixed interest securities and USD nil (2015 – USD 1.0 million) of cash to collateralise the letters of credit.

Effective 14 May 2012, the Company entered into a Revolving Letter of Credit Facility Agreement ("Mizuho Facility") with Mizuho Corporate Bank Ltd. ("Mizuho Bank"). The Mizuho Facility provided commitments from Mizuho Bank in an aggregate amount of USD 300.0 million and provided for the issuance and renewal of letters of credit which are used to support the Company's reinsurance obligations. The Mizuho Facility was amended effective 21 January 2015 (the "Amended Mizuho Facility Agreement"). Under the Amended Mizuho Facility Agreement, the Mizuho Facility was increased to USD 600.0 million and letters of credit can be issued in Australian Dollars. The termination date was amended effective 16 January 2016 and extended to 16 January 2017. A further amendment effective 16 January 2017 extended the commitment termination date to 16 January 2019. The Mizuho Facility contains representations, warranties, and covenants customary for facilities of this type.

At 31 December 2016, Mizuho Bank has issued letters of credit of USD 555.3 million (2015 – USD 470.1 million) in favour of ceding companies.

27. RELATED PARTY DISCLOSURES

Transactions with affiliates

The following transactions were conducted with related parties during the year and are based on arm's length arrangements:

(a) The Company assumed several reinsurance agreements from related parties under common control. The reinsurance premiums assumed under these agreements totalled USD 40.1 million (2015 – USD 18.6 million) with associated acquisition expenses of USD 3.1 million (2015 – USD 0.6 million) and net loss and loss expenses incurred of USD 7.9 million (2015 – USD 3.2 million). At 31 December 2016, the consolidated balance sheet includes USD 17.8 million (2015 – USD 2.7 million), USD 18.0 million (2015 – USD 1.8 million) and USD 2.1 million (2015 – USD 0.2 million) of premiums receivable, unearned premium, and deferred acquisition costs, respectively.

In addition, the Company assumed a catastrophe swap derivative contract from a related party under common control during the year. The derivative premiums assumed under the agreement totalled USD 1.5 million (2015 – USD 4.1 million).

(b) Effective 1 July 2015, Tokio Millennium Re AG – United Kingdom Branch ("TMRUK") entered into a loss portfolio transfer agreement ("LPTA") with Tokio Marine Global Re Asia Ltd. ("TMG Re Asia") for a consideration of USD 43.8 million. Reserves (outstanding losses and loss expenses and unearned premiums) were transferred and recorded in TMRUK's balance sheet. The LPTA has been accounted for under insurance accounting.

At 31 December 2016, the consolidated balance sheet includes USD 32.9 million, USD 0.3 million, USD 27.8 million, USD 1.6 million and USD 1.5 million of cash, premiums receivable, outstanding losses and loss expenses, deferred fee income and accounts payable, respectively, in relation to this LPTA. The amortisation of deferred fee income is based on the expected claims payout pattern and settlement period.

At 31 December 2015, the consolidated balance sheet includes USD 36.9 million, USD 3.8 million, USD 36.4 million, USD 1.8 million and USD 2.1 million of cash, premiums receivable, outstanding losses and loss expenses, deferred fee income and accounts payable, respectively, in relation to this LPTA.

(c) Effective 1 July 2015, the Company established an investment management agreement with a related party under common control. The Company incurred investment management fees of USD 3.2 million for the year ended 31 December 2016 (2015 – USD 1.0 million). The consolidated balance sheet includes USD 0.8 million of accounts payable and accrued expenses at 31 December 2016 (2015 – USD 0.6 million).

Key management personnel compensation

The aggregate remuneration of Directors and key management was as follows:

USD '000	2016	2015
Wages and salaries	2,612	3,498
Long term incentive compensation plan	925	1,527
Retirement benefit obligation costs	302	326
Bonus and other benefits	1,653	1,718
	5,492	7,069

28. STATUTORY REQUIREMENTS

TMR AG is supervised by the Swiss Financial Market Supervisory Authority ("FINMA"), the Bermuda Monetary Authority ("BMA"), the Australian Prudential Regulation Authority ("APRA"), the New York State Department of Financial Services ("NYSDFS"), the Prudential Regulation Authority ("PRA") and the Financial Conduct Authority ("FCA").

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.

(a) Switzerland

The Company (since redomestication) and the Swiss operation are regulated by FINMA, pursuant to the Insurance Supervisory Law. The Company's accounts are prepared in accordance with the Swiss Code of Obligations, the Insurance Supervisory Law and the Insurance Supervisory Ordinance.

TMR AG is obligated to maintain a minimum level of capital based on the Swiss Code of Obligations and Insurance Supervisory Law. In addition, the Company is required to perform a minimum solvency margin calculation based on the Swiss Solvency Test ("SST") regulations, as stipulated by the Insurance Supervisory Law. The SST is based on an economic view and required capital is derived from a combination of internal and standard models. The amount of dividends that TMR AG is permitted to distribute is restricted to freely distributable reserves which consist of retained earnings and the current year profit. The solvency and capital requirements must still be met following any distribution.

The Company calculated an SST ratio of 250% for SST 2016. The minimum ratio for the SST is set at 100%. TMR AG is expected to exceed the minimum ratios for the year ending 31 December 2016.

(b) Bermuda

Tokio Millennium Re AG – Bermuda Branch ("TMRB") is registered under The Insurance Act 1978 (Bermuda), Amendments thereto and Related Regulations (the "Insurance Act") as a Class 3B insurer. Under the Insurance Act, the Company is required to annually prepare and file statutory and IFRS financial statements and a statutory financial return. The Insurance Act also requires the Company to maintain minimum levels of statutory capital and surplus. At 31 December 2015, this amount was USD 201.2 million and the actual statutory capital and surplus was USD 830.8 million. The Company is expected to exceed this minimum requirement for the year ending 31 December 2016.

The Bermuda Solvency Capital Requirement ("BSCR") is a risk based capital model used to determine an enhanced capital requirement and target capital level (defined as 120% of the enhanced capital requirement) for Class 3B insurers. The prescribed form of capital and solvency return, comprises the insurer's BSCR model, a schedule of fixed income investments by rating category, a schedule of net loss and loss expense provision by line of business, a schedule of premiums written by line of business, a schedule of risk management and a schedule of fixed income securities by security type. The BSCR includes a standardised model used to measure the risk associated with an insurer's assets, liabilities and premiums, and a formula to take account of catastrophe risk exposure. The Authority requires all Class 3B insurers to maintain their capital at a target level which is 120% of the amount calculated in accordance with the BSCR or the Company's approved internal model (the Enhanced Capital Requirement or "ECR"). In addition, TMRB is required to maintain a minimum solvency margin. Both requirements have been met.

The Insurance Act limits the maximum amount of annual dividends and distributions that may be paid by the Company in any year which would exceed 25% of its prior year statutory capital and surplus or reduce its prior year statutory capital by 15% or more, without the prior approval of the BMA. Furthermore, the Company is not permitted to declare or pay a dividend, or make a distribution out of contributed surplus, if the realisable value of its assets would be less than the aggregate of its liabilities, issued share capital and share premium accounts. During 2016, the Company distributed a total of USD 5.9 million (2015 – USD 71.3 million) to Tokio Marine Holdings, Inc. and no approval was required.

The Company is also required to maintain a minimum liquidity ratio whereby the value of its relevant assets is not less than 75% of the amount of its relevant liabilities and this has been met. Relevant assets include cash and cash equivalents, short term investments, catastrophe bonds, fixed interest securities, accrued interest receivable, premiums receivable, funds withheld and other assets. Certain categories of assets do not qualify as relevant assets under the statute. Relevant liabilities are outstanding losses and loss expenses, unearned premiums, deferred fee income, funds withheld ceded, accounts payable and accrued expenses, net of outstanding losses recoverable from reinsurers and prepaid reinsurance premiums.

28. STATUTORY REQUIREMENTS (continued)

(c) Australia

Tokio Millennium Re AG – Australia Branch ("TMRA") is authorised to carry on insurance business under subsection 12(2) of the Insurance Act 1973. TMRA is regulated by the Australian Prudential Regulation Authority ("APRA") in accordance with the Insurance Act 1973 and APRA Prudential Standards. TMRA's regulatory reporting is prepared in accordance with the Australian Accounting Standards and APRA Prudential Standards. TMRA have complied with the APRA requirements in both 2016 and 2015.

APRA Prudential Standards require the maintenance of net assets in Australia in excess of a calculated Prescribed Capital Amount ("PCA"). The net assets in Australia at 31 December 2016 were USD 82.8 million (2015 – USD 79.2 million) and resulted in a surplus of USD 42.9 million (2015 – USD 39.5 million) above the PCA of USD 39.9 million (2015 – USD 39.7 million) estimated under the new Prudential Standards.

TMRA has an Internal Capital Adequacy Assessment Process ("ICAAP") to ensure compliance with regulatory capital requirements. In accordance with the ICAAP, TMRA monitors its capital adequacy in order to ensure compliance with the relevant capital targets.

(d) United States

Tokio Millennium Re AG – United States Branch ("TMRUS") is required to file a set of financial statements prepared in accordance with statutory accounting practices prescribed or permitted by the United States insurance regulators. Statutory net income and statutory surplus, as reported to the insurance regulatory authorities, differ in certain respect from the amounts prepared in accordance with IFRS and the main differences relate to the treatment of deferred acquisition costs, deferred income, unrealised appreciation or decline in value of investments and non admitted assets and deferred income taxes.

Minimum required statutory capital and surplus is based on the greater of the Risk Based Capital (RBC) level that would trigger regulatory action or minimum requirements per state insurance regulation. At both 31 December 2016 and 2015, TMRUS exceeded the minimum required statutory capital and surplus requirement and also exceeded the RBC minimum required level. TMRUS is required to maintain a minimum combined statutory surplus of USD 109.7 million. As of 31 December 2016, the statutory surplus was USD 194.7 million (2015 – USD 217.9 million).

TMRUS as a United States Branch does not pay ordinary dividends and would need approval from the New York State Department of Financial Services for any return of capital to TMR AG. As of 31 December 2016, TMRUS did not return any capital to TMR AG. Any return of capital in subsequent periods would need to be approved by the NYSDFS based on the financial condition of TMRUS.

(e) United Kingdom

Tokio Millennium Re AG – United Kingdom Branch ("TMRUK") is authorised by the Prudential Regulation Authority ("PRA"), and regulated jointly by the PRA and Financial Conduct Authority ("FCA"). The PRA oversees compliance with established periodic auditing and reporting requirements, minimum solvency margins, and capital assessment requirements. Both the PRA and the FCA oversee compliance with risk assessment reviews and various other requirements.

At 31 December 2016, TMRUK was subject to the Solvency I regime. However, as a new United Kingdom Branch, a waiver was submitted for the branch to be exempted from the Solvency I return submission. For Solvency II, the PRA granted a modification of the rules and only required TMRUK to provide the following: a) annual Swiss Solvency Test ("SST") as submitted to FINMA; b) annual TMR Group Own Risk and Solvency Assessment ("ORSA"); c) TMRUK capital and reserves; and d) TMRUK quarterly and annual balance sheet and income statement.

TMRUK is also not required to hold localised assets.

29. SUBSEQUENT EVENTS

The Company has completed its subsequent events evaluation for the period subsequent to the consolidated balance sheet date of 31 December 2016, through 14 March 2017, the date the consolidated financial statements were authorised for issue. There were no subsequent events that would warrant an adjustment to the consolidated financial statements.

HISTORICAL FINANCIAL DATA

31 December 2016, 2015, 2014, 2013, and 2012

Consolidated Balance Sheet

USD '000	2016	2015	2014	2013	2012
Assets					
Cash and cash equivalents	313,775	279,037	167,760	127,225	102,863
Funds withheld	71,768	78,996	52,801	49,509	54,185
Investments	2,256,285	1,993,777	1,968,316	1,635,738	1,515,353
Deposit assets	393,823	296,177	337,677	–	–
Premiums receivable	856,770	716,399	474,583	355,434	251,115
Outstanding losses recoverable from reinsurers	64,975	52,730	51,473	30,669	94,083
Deferred acquisition expenses	359,834	327,938	201,528	135,916	108,756
Other assets	116,091	105,702	96,318	79,317	70,247
Total assets	**4,433,321**	**3,850,756**	**3,350,456**	**2,413,808**	**2,196,602**
Liabilities					
Outstanding losses and loss expenses	1,114,659	857,700	699,305	583,691	537,381
Liability for collateral held on behalf of counterparties	185,536	233,617	315,250	22,878	21,772
Reinsurance balances payable	93,162	89,107	53,023	18,222	71,291
Deposit liabilities	393,823	296,177	337,677	–	–
Unearned premiums	1,237,051	1,083,347	688,827	483,295	365,729
Other liabilities	88,333	84,914	57,059	32,663	27,089
Total liabilities	**3,112,564**	**2,644,862**	**2,151,141**	**1,140,749**	**1,023,262**
Shareholder's equity					
Share capital	250,000	250,000	250,000	250,000	250,000
Contributed surplus	400,000	400,000	400,000	400,000	400,000
Retained earnings	715,127	600,349	563,807	632,537	492,511
Accumulated other comprehensive income	(44,370)	(44,455)	(14,492)	(9,478)	30,829
Total shareholder's equity	**1,320,757**	**1,205,894**	**1,199,315**	**1,273,059**	**1,173,340**
Total liabilities and shareholder's equity	**4,433,321**	**3,850,756**	**3,350,456**	**2,413,808**	**2,196,602**

HISTORICAL FINANCIAL DATA

31 December 2016, 2015, 2014, 2013, and 2012

Consolidated Statement of Comprehensive Income

USD '000	2016	2015	2014	2013	2012
Revenue					
Net premiums written	1,317,916	1,339,318	1,009,259	779,005	727,572
Net premiums earned	1,139,119	931,556	799,803	664,449	615,059
Other operating income	21,190	18,819	23,757	4,303	7,629
Total operating income	1,160,309	950,375	823,560	668,752	622,688
Net investment income	60,872	35,310	36,420	34,272	34,680
Total revenue	**1,221,181**	**985,685**	**859,980**	**703,024**	**657,368**
Expenses					
Net loss and loss expenses incurred	666,540	507,430	463,431	308,422	255,799
Acquisition expenses	314,337	251,546	220,927	146,244	173,953
General and administrative expenses	108,616	106,358	83,345	78,158	68,814
Net derivative expense	–	–	–	17,461	23,814
Other expense	8,246	11,301	17,763	10,099	9,664
Total expenses	**1,097,739**	**876,635**	**785,466**	**560,384**	**532,044**
Profit before tax	**123,442**	**109,050**	**74,514**	**142,640**	**125,324**
Tax expense	(2,770)	(1,238)	(3,244)	(2,614)	(1,767)
Profit	**120,672**	**107,812**	**71,270**	**140,026**	**123,557**