Manulife Re.

2017 Annual Report

Manufacturers P&C Limited

Independent Auditor's Report

To the shareholder of
Manufacturers P&C Limited

Report on the Audit of the Financial Statements

Opinion

We have audited the accompanying financial statements of Manufacturers P&C Limited ("the Company"), which comprise the statement of financial position as at 31 December 2017, and the statement of loss, statement of comprehensive loss, statement of changes in shareholder's equity and statement of cash flows for the year then ended, and notes to the financial statements including a summary of significant accounting policies.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of Manufacturers P&C Limited as at 31 December 2017 and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards ("IFRSs").

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing ("ISAs"). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of Manufacturers P&C Limited in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants ("IESBA Code"), and we have fulfilled our other ethical responsibilities in accordance with the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Responsibilities of Management and Board of Directors for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with IFRSs, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with Governance are responsible for overseeing the Company's financial reporting process.

Independent Auditor's Report

To the shareholder of Manufacturers P&C Limited

Report on the Audit of the Financial Statements (continued)

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

Independent Auditor's Report

To the shareholder of
Manufacturers P&C Limited

Report on the Audit of the Financial Statements (continued)

Auditor's Responsibilities for the Audit of the Financial Statements (continued)

We communicate with those charged with Governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

Ernst & Young Ltd

Bridgetown
Barbados
9 March 2018

Statement of Financial Position

As at December 31
(Expressed in thousands of U.S. Dollars)

		2017		2016
Assets				
Cash and cash equivalents (Note 5)	$	16,874	$	20,986
Investments (Note 4)		347,657		190,986
Premiums receivable		23,505		592
Accrued investment income		905		1,138
Capital assets, net of accumulated depreciation		556		683
Other assets		60,950		453
Balance due from related companies (Note 5)		10		19
	$	450,457	$	214,857
Liabilities				
Loss reserves (Note 6)	$	217,987	$	1,307
Unearned premium reserve		4,080		4,801
Accounts payable and accrued liabilities		3,557		5,031
Balance due to related companies (Note 5)		97		217
	$	225,721	$	11,356
Shareholder's Equity				
Share capital (Note 8)	$	340,000	$	190,000
Accumulated (deficit) earnings		(107,447)		24,834
Accumulated other comprehensive loss		(7,817)		(11,333)
	$	224,736	$	203,501
	$	450,457	$	214,857

The accompanying notes to these financial statements are an integral part of these statements.

Claudio Macchi
Director

Philip Witherington
Director

Statement of (Loss) Income

For the year ended December 31
(Expressed in thousands of U.S. Dollars)

		2017		2016
Revenue				
Reinsurance premiums written (Note 6)	$	83,346	$	64,669
Change in unearned premium reserve		721		367
Reinsurance premiums earned		84,067		65,036
Investment income (Note 4)		5,170		19,438
	$	89,237	$	84,474
Expenses				
Losses incurred (recovered) (Note 6)	$	216,722	$	(2,255)
Commisions and brokerage		2,305		2,446
General and administrative expenses		2,491		4,909
	$	221,518	$	5,100
Net (loss) income	$	(132,281)	$	79,374

Statement of Comprehensive (Loss) Income

For the year ended December 31
(Expressed in thousands of U.S. Dollars)

		2017		2016
Net (loss) income	$	(132,281)	$	79,374
Other comprehensive income loss: Unrealized gain (loss) on investments		3,516		(16,366)
Total comprehensive (loss) income	$	(128,765)	$	63,008

The accompanying notes are an integral part of these financial statements.

Statement of Changes in Equity

For the year ended December 31
(Expressed in thousands of U.S. Dollars)

		2017		2016
Common shares				
Balance, beginning of year	$	190,000	$	190,000
Issue of shares (Note 8)		200,000		-
Capital reduction (Note 8)		(50,000)		-
Balance, end of year	$	340,000		190,000
(Accumulated Deficit)/Retained earnings	$	24,834	$	20,460
Balance, beginning of year				
Net (loss) income		(132,281)		79,374
Common shares dividends (2016 - 39 cents per share)		-		(75,000)
Balance, end of year	$	(107,447)	$	24,834
Accumulated other comprehensive (loss) income				
Balance, beginning of year	$	(11,333)	$	5,033
Other comprehensive income (loss)		3,516		(16,366)
Balance, end of year	$	(7,817)	$	(11,333)
Total equity	$	224,736	$	203,501

The accompanying notes are an integral part of these financial statements..

Statement of Cash Flows

For the year ended December 31
(Expressed in thousands of U.S. Dollars)

		2017		2016
Operating activities				
Net (loss) income	$	(132,281)	$	79,374
Adjustment for non-cash items:				
Depreciation of capital assets		150		141
Amortization of (discount) premium on bonds		(223)		30
Gain on sale of investments		(78)		(14,714)
Loss (Gain) on sale of capital assets		3		(43)
Net income adjusted for non-cash items		(132,429)		64,788
Net change in non-cash assets and liabilities (Note 10)		131,197		(1,684)
Cash (used in) provided by operating activities	$	(1,232)	$	63,104
Investing activities				
Net purchase of capital assets	$	(26)	$	(41)
Purchase of investments		(271,079)		(152,318)
Proceeds from the sale and maturity of investments		118,225		153,116
Cash (used in) provided by investing activities	$	(152,880)	$	757
Financing activities				
Common shares issued	$	200,000	$	-
Capital reduction		(50,000)		-
Shareholder dividends paid in cash		-		(75,000)
Cash provided by (used in) financing activities	$	150,000	$	(75,000)
Cash and cash equivalents				
Decrease during the year	$	(4,112)	$	(11,139)
Balance, beginning of year		20,986		32,125
Balance, end of year	$	16,874	$	20,986
Cash and cash equivalents consist of:				
Cash	$	16,874	$	11,981
Short-term bonds		-		9,005
	$	16,874	$	20,986
Supplemental disclosure on cash flow information:				
Interest received	$	5,107	$	4,471

The accompanying notes are an integral part of these financial statements

Notes to the Financial Statements

December 31, 2017
(Expressed in thousands of U.S. Dollars)

1. Nature of Operations

Manufacturers P & C Limited ("the Company") is a limited company incorporated under the Laws of Bermuda on June 26, 1986. The Company filed Articles of Continuance under the Laws of Barbados on January 1, 1996 and is a wholly owned subsidiary of Manulife Holdings (Bermuda) Limited ("MHBL"). MHBL is a wholly owned subsidiary of The Manufacturers Life Insurance Company ("MLI"), a company incorporated in Canada that is a wholly owned subsidiary of Manulife Financial Corporation ("MFC"), a publicly traded holding company incorporated in Canada.

The Company is principally engaged in the provision of reinsurance coverage for certain property and casualty insurance risks.

The registered office of the Company is located at The Goddard Building, Haggatt Hall, St. Michael, Barbados.

The financial statements of the Company as at and for the year ended December 31, 2017 were authorized for issue in accordance with a resolution of the directors on March 9, 2018.

2. Significant Accounting Policies

These financial statements are prepared in accordance with International Financial Reporting Standards ("IFRS"). The preparation of 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 and liabilities, the disclosure of contingent assets and liabilities as at the date of the financial statements, and the reported amounts of revenue and expenses during the reporting periods. Actual results may differ from these estimates. The most significant estimation processes relate to the determination of loss reserves and the fair value of certain financial instruments. Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the year in which the estimates are revised and in any future years affected. Although some variability is inherent in these estimates, management believes that the amounts recorded are appropriate.

The significant accounting policies used and the most significant judgments made by management in applying the accounting policies in the preparation of these financial statements are summarized below:

(a) Cash and cash equivalents

Cash and cash equivalents comprise cash at bank and in hand, cash held in liquidity pools, and short-term bonds which have an original term to maturity of three months or less from the original acquisition date. Cash and cash equivalents are carried at cost, which approximates fair value.

(b) Investments

Bonds are designated as available-for-sale and are carried at fair value. All investments are initially recognized at cost, being the fair value of the consideration given, including acquisition charges associated with the security. After initial recognition, investments are measured at fair value. Changes in fair value are recorded in other comprehensive income until the investment is derecognized or the investment is determined to be impaired.

For investments that are actively traded in organized financial markets, fair value is determined by reference to stock exchange quoted market prices at the close of business on or immediately before the date of statement of financial position. All marketable security transactions are recognized on the trade date.

Investments are reviewed for impairment whenever events or circumstances indicate that the carrying amount may not be recoverable. The identification of impairment and the determination of recoverable amounts is an inherently uncertain process involving various assumptions and factors, including the financial condition of the counter party, expected future cash flows, observable market prices and expected net selling prices. All investment securities for which the market value has been significantly below amortized cost for a considerable period of time are individually reviewed. A distinction is made between circumstances attributed to general market fluctuations and those attributed to issuer specific developments.

The impairment review focuses on issuer specific developments regarding financial condition and future prospects, taking into account the intent and ability to hold the securities under the Company's long-term investment strategy. The amount of an impairment loss is measured as the difference between the investment's carrying amount and the present value of estimated future cash flows discounted at the investment's original effective interest rate. Impairment losses are recognized in income.

Realized gains and losses on disposal of available-for-sale investments, amortization of premiums or discounts arising on the acquisition of investments and impairment differences are recorded in income.

Interest income is recognized on an accrual basis using the effective interest method.

(c) Premiums

Premiums are reflected in income evenly over the terms of the reinsurance contracts. Unearned premiums represent amounts that relate to the unexpired portion of the contract.

(d) Capital assets

Capital assets are carried at cost less accumulated depreciation and any accumulated impairment losses. Depreciation is calculated based on the cost of an asset less its residual value and is recognized in income on a straight-line basis over the estimated useful life ranging from three to ten years. Impairment losses are recorded in income to the extent the recoverable amount is less than the carrying amount.

(e) Loss reserves

The Company makes a provision for losses incurred but not reported, for the development of reported losses and for loss handling expenses advised by the ceding company in accordance with the terms of the contracts and supported by management estimates, and where appropriate, actuarial analysis. These estimates are continually reviewed and adjusted where necessary.

The determination of the provision for losses and related loss expenses is based on expected trends in loss severity and frequency and other factors that may vary as losses are settled, and will take into account any loss mitigation penalty that is contractually due to the Company upon cancellation by a cedant following a loss. Ultimate losses may differ from the amounts recorded in the financial statements. Changes in the amount of loss reserves are recorded in income as part of losses incurred.

(f) Insurance contract classification

The contracts reinsured by the Company are considered insurance contracts under which the Company accepts significant insurance risk from a ceding company. A contract is considered to have significant insurance risk if, and only if, an insured event could cause an insurer to make significant additional payments in any scenario, excluding scenarios that lack commercial substance at the inception of the contract. Once a contract has been classified as an insurance contract, it remains an insurance contract even if the insurance risk reduces significantly.

(g) Foreign currency transactions

The financial statements are expressed in United States dollars, the functional currency in which the Company operates. Assets and liabilities denominated in foreign currencies are translated at the exchange rate in effect at the reporting date. Revenue and expenses denominated in foreign currencies are translated at the average exchange rate prevailing during the year. Gains and losses arising from foreign currency translation are included in income.

(h) Impairment of financial assets

In addition to any impairment provision related to available-for-sale investments discussed above, a provision for impairment of other financial assets is established when there is objective evidence that the Company will not be able to collect amounts due. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognized in income.

(i) Fair value measurement

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction (not a forced liquidation or distressed sale) between market participants at the measurement date, that is, an exit value. When available, quoted market prices are used to determine fair value. If quoted market prices are not available, fair value is typically based upon alternative valuation techniques such as discounted cash flows, matrix pricing, consensus pricing services and other techniques. Broker quotes are generally used when external public vendor prices are not available.

The Company has a process in place that includes a review of price movements relative to the market, a comparison of prices between vendors, and a comparison to internal matrix pricing which uses predominately external observable data. Judgment is applied in adjusting external observable data for items including liquidity and credit factors.

(j) Employee future benefits

The Company maintains a defined contribution pension plan for eligible employees. The defined contribution plan provides pension benefits based on the accumulated contributions and investment earnings thereon. The cost of the defined contribution plan is the contribution provided by the Company and is recognized in income in the periods during which services are rendered by employees.

3. Accounting and Reporting Changes

The accounting standards are consistent with those of the previous financial year except for standards noted below. Summaries of the relevant accounting standards adopted by the Company during 2017 and those that will become effective subsequently, are presented below:

(a) Changes in accounting polices

(i) Annual improvements to IFRS Standards 2014 – 2016 Cycle

Effective January 1, 2017, the Company adopted certain amendments issued within the Annual Improvements to IFRS Standards 2014-2016 Cycle, as issued by the IASB in December 2016. There are various minor amendments which are effective in 2017, with other amendments being effective January 1, 2018. The currently effective amendments were applied retrospectively. Adoption of these amendments did not have a significant impact on the Company's financial statements.

(ii) Amendments to IAS 7 "Statements of Cash Flows"

Effective January 1, 2017, the Company adopted the amendments issued in January 2016 to IAS 7 "Statement of Cash Flows". These amendments were applied prospectively. These amendments require companies to provide information about changes in their financing liabilities. Adoption of these amendments did not have a significant impact on the Company's financial statements.

(b) Future accounting and reporting changes

(i) IFRS 9 "Financial Instruments"

IFRS 9 "Financial Instruments" was issued in November 2009 and amended in October 2010, November 2013 and July 2014, and is effective for years beginning on or after January 1, 2018, to be applied retrospectively, or on a modified retrospective basis. Additionally, the IASB issued amendments in October 2017 that are effective for annual periods beginning on after January 1, 2019. The standard is intended to replace IAS 39 "Financial Instruments: Recognition and Measurement".

The project has been divided into three phases: classification and measurement, impairment of financial assets, and hedge accounting. IFRS 9's current classification and measurement methodology provides that financial assets are measured at either amortized cost or fair value on the basis of the entity's business model for managing the financial assets and the contractual cash flow characteristics of the financial assets. The classification and measurement for financial liabilities remains generally unchanged; however, for a financial liability designated as at fair value through profit or loss, revisions have been made in the accounting for changes in fair value attributable to changes in the credit risk of that liability.

Gains or losses caused by changes in an entity's own credit risk on such liabilities are no longer recognized in profit or loss but instead are reflected in other comprehensive income ("OCI").

Revisions to hedge accounting were issued in November 2013 as part of the overall IFRS 9 project. The amendment introduces a new hedge accounting model, together with corresponding disclosures about risk management activity for those applying hedge accounting. The new model represents a substantial overhaul of hedge accounting that will enable entities to better reflect their risk management activities in their financial statements.

Revisions issued in July 2014 replace the existing incurred loss model used for measuring the allowance for credit losses with an expected loss model. Changes were also made to the existing classification and measurement model designed primarily to address specific application issues raised by early adopters of the standard. The revision also address the income statement accounting mismatches and short-term volatility issues which have been identified as a result of the insurance contracts project.

Revisions issued in October 2017 allow financial assets to be measured at amortized cost or fair value through OCI even if the lender is required to pay a reasonable compensation in the event of an early termination of the contract by the borrower (also referred to as prepayment features with negative compensation).

The Company expects to defer IFRS 9 until January 1, 2021, as allowed under the amendments to IFRS 4 "Insurance Contracts" outlined below. The Company is assessing the impact of this standard.

(ii) Amendments to IFRS 4 "Insurance Contracts"

Amendments to IFRS 4 "Insurance Contracts" were issued in September 2016, which are effective for annual periods beginning on or after January 1, 2018. The amendments introduce two approaches to address concerns about the differing effective dates of IFRS 9 "Financial Instruments" and IFRS 17 "Insurance Contracts": the overlay approach and the deferral approach. The overlay approach provides an option for all issuers of insurance contracts to adjust profit or loss for eligible financial assets by removing any additional accounting volatility that may arise from applying IFRS 9 before IFRS 17 is implemented. The deferral approach provides companies whose activities are predominantly related to insurance an optional temporary exemption from applying IFRS 9 until January 1, 2021. The Company qualifies for the exemption and intends to defer IFRS 9 until January 1, 2021.

(iii) IFRS 15 "Revenue from Contracts with Customers"

IFRS 15 "Revenue from Contracts with Customers" was issued in May 2014 and replaces IAS 11 "Construction Contracts", IAS 18 "Revenue" and several interpretations. Amendments to IFRS 15 were issued in April 2016. IFRS 15 as amended is effective for annual periods beginning on or after January 1, 2018. The Company will adopt IFRS 15 effective January 1, 2018, using the modified retrospective method with no restatement of comparative information.

IFRS 15 clarifies revenue recognition principles, provides a robust framework for recognizing revenue and cash flows arising from contracts with customers and enhances qualitative and quantitative disclosure requirements. IFRS 15 does not apply to insurance contracts, financial instruments and lease contracts.

The Company's service arrangements are generally satisfied over time, with revenue measured and collected from customers within a short term, as services are rendered.

Adoption of IFRS 15 is not expected to have a significant impact on the Company's financial statements.

(iv) IFRS 17 "Insurance Contracts"

IFRS 17 was issued in May 2017 and is effective for years beginning on January 1, 2021, and to be applied retrospectively. If full retrospective application to a group of contracts is impractical, the modified retrospective or fair value methods may be used. The standard will replace IFRS 4 "Insurance Contracts" and will materially change the recognition and measurement of insurance contracts and the corresponding presentation and disclosures in the Company's financial statements. The Company is assessing the implications of this standard and expect that it will have a significant impact on the Company's financial statements. In addition, in certain jurisdictions, it could have a material effect on tax and regulatory capital positions that are dependent upon IFRS accounting values

(v) IFRS 16 "Leases"

IFRS 16 "Leases" was issued in January 2016 and is effective for years beginning on or after January 1, 2019, to be applied retrospectively or on a modified retrospective basis. It will replace IAS 17 "Leases" and IFRIC 4 "Determining whether an arrangement contains a lease". IFRS 16 sets out the principles for the recognition, measurement, presentation and disclosure of leases for both parties to a contract, the customer ("lessee") and the supplier ("lessor"). The standard brings most leases onto the Statement of Financial Position for lessees under a single model, eliminating the previous classifications of operating and finance leases. Exemptions to this treatment are for lease contracts with low value assets or leases with duration of less than one year. The on-balance sheet treatment will result in the grossing up of the balance sheet due to right-of-use assets being recognized with offsetting liabilities. Lessor accounting will remain largely unchanged with previous classifications of operating and finance leases being maintained. The Company is assessing the impact of this standard

(vi) IFRS Interpretation Committee ("IFRIC") Interpretation 22 "Foreign Currency Transactions and Advance Consideration"

IFRIC 22 "Foreign Currency Transactions and Advance Consideration" was issued in December 2016 and is effective for annual periods beginning on or after January 1, 2018 and may be applied retrospectively or prospectively. IFRIC 22 addresses which foreign exchange rate to use to measure a foreign currency transaction when advance payments are made or received and non-monetary assets or liabilities are recognized prior to recognition of the underlying transaction. IFRIC 22 does not relate to goods or services accounted for at fair value or at the fair value of consideration paid or received at a date other than the date of initial recognition of the non-monetary asset or liability, or to income taxes, insurance contracts or reinsurance contracts. The foreign exchange rate on the day of the advance payment is used to measure the foreign currency transaction. If multiple advance payments are made or received, each payment is measured separately. The Company is assessing the impact of this standard. Adoption of IFRIC 22 is not expected to have a significant impact on the Company's Financial Statements.

(vii) Annual Improvements 2015-2017 Cycle

Annual Improvements 2015 – 2017 Cycle was issued in December 2017 and is effective for years beginning on or after January 1, 2019. The IASB issued three minor amendments to different standards as part of the Annual Improvements process, with the amendments to be applied prospectively. Adoption of these amendments is not expected to have significant impact on the Company's financial statements.

4. Investments

(a) Invested assets

For the year ended December 31		2017	2016
	Term to maturity	Fair Value	Fair Value
Government bonds	<1 year	$ 220,221	$ 1,001
	1-5 years	43,469	85,114
	>5 years	68,106	78,750
		331,796	164,865
Corporate bonds	<1 year	2,563	5,333
	1-5 years	12,284	19,775
	>5 years	1,014	1,013
		15,861	26,121
Total		$ 347,657	$ 190,986

Since all invested assets are classified as available-for-sale, investments are carried at their fair values as at December 31, 2017. Fair values for bonds are determined with reference to quoted bid prices where available. When such prices are not available, fair values are determined using techniques which include security specific interest rates and discounted cash flows based on observable market data.

(b) Investment income

Investment income is comprised as follows:

For the year ended December 31		2017		2016
Interest Income	$	4,874	$	4,754
Amortization of discount (premium) on bonds		223		(30)
Amortization of premium on short term deposits		(5)		-
Gain on sales of investment		78		14,714
	$	5,170	$	19,438

5. Related Party Transactions

All related party transactions are on an arm's length basis on normal commercial terms, and amounts due from and to related parties are unsecured, interest free and payable on demand.

(a) Balances due from related companies

For the year ended December 31		2017		2016
Manufacturers Life Insurance Company (Barbados Branch)	$	10	$	15
Manulife Asset Management International Holdings Limited		-		4
	$	10	$	19

(b) Balances due to related companies

For the year ended December 31		2017		2016
John Hancock Life Insurance Company (U.S.A.)	$	62	$	128
Manufacturers Life Insurance Company		35		89
	$	97	$	217

(c) Liquidity pool

The Company participates in a liquidity pool of an affiliate, Manulife Management Services Ltd. as set forth in the terms of a Grid Note dated April 3, 2006. The maximum aggregate amount that the Company can invest into this liquidity pool is $500,000. The balance in the liquidity pool was $15,736 (2016 - $10,741) and is included in cash and cash equivalents of $16,874 (2016 - $20,986). The interest earned was $534 (2016 – $30).

(d) General and administrative expenses

Included in general and administrative expenses is an amount of $1,047 (2016 - $1,219), which represents amounts charged under agreements whereby certain administrative services are provided by affiliated companies.

(e) Compensation of key management personnel

Key management personnel of the Company are those that have the authority and responsibility for planning, directing and controlling the activities of the Company. Directors (both executive and non-executive) and senior management are considered key personnel. Accordingly, the summary of compensation of key management personnel is as follows:

For the year ended December 31	2017	2016
Short-term employee benefits	$ 1,854	$ 2,204
Pension contribution	62	58
	$ 1,916	$ 2,262

6. Loss reserves and reinsurance premiums written

The change in loss reserves during the year was a result of the following:

For the year ended December 31	2017	2016
Balance, beginning of the year	$ 1,307	$ 4,068
Losses incurred (recovered) relating to contracts written in:		
Current year	215,550	–
Prior year	1,172	(2,255)
Total losses incurred (recovered)	216,722	(2,255)
Losses paid relating to contracts written in:		
Prior year	(42)	(506)
Total losses paid	(42)	(506)
Balance, end of the year	$ 217,987	$ 1,307

As discussed in Note 7(d), the Company is exposed to losses arising from catastrophic events. During 2017, the Company established a loss reserve for the estimated loss impact to its portfolio for Hurricanes Harvey, Irma and Maria which severely affected parts of the United States of America, U.S territory of Puerto Rico and the Caribbean. Expected loss impacts for California wildfires are also included in this reserve. Due to the uncertainty of the overall and individual impact of the series of these major losses to our treaties, the amounts reserved may ultimately be settled in total for amounts lesser or greater than the reserve established, and the difference may be material.

The following table shows the impact of reinstatement premiums on the Company's reported premium income.

For the year ended December 31	2017	2016
Gross premiums	$ 60,731	$ 65,523
Reinstatement premiums [1]	22,615	(854)
Reinsurance premiums written	$ 83,346	$ 64,669

[1] The 2016 balance represents release of reinstatement premium on prior year reserves. The 2017 balance represents reinstatement premium related to 2017 loss reserves.

7. Risk Management

The Company employs an enterprise-wide approach to all risk taking and risk management activities. The Company's enterprise risk management framework sets out policies and standards of practice related to governance, identification and monitoring, measurement and control, and mitigation of key risks. Individual risk management strategies are in place for each specific key risk within the Company's broad risk categories: strategic, market and liquidity (includes market price, interest rate, foreign currency and liquidity risks), credit, insurance and operational.

(a) Market price and interest rate risk

Due to the nature of the insurance business, invested assets and insurance liabilities as well as revenues and expenses are impacted by movements in capital markets, interest rates and credit spreads. Accordingly, the Company considers these risks together in managing its asset and liability positions and ensuring that risks are properly managed. These risks are referred to collectively as market price and interest rate risk – the risk of loss resulting from adverse movements in market price, interest rates and credit spreads.

The following table shows the potential impact on shareholder's equity of a change of one per cent in interest rates:

	1% change in interest rates			
As at December 31, 2017		+100bps		-100bps
Invested assets	$	(14,709)	$	18,555
As at December 31, 2016				
Invested assets	$	(14,536)	$	18,204

The Company is exposed to interest rate risk in the event of a mismatch between the cash flows from the assets and liabilities. Management has established policies and guidelines for the matching of assets and liabilities designed to keep this exposure within acceptable limits. The yield on the Corporate bonds ranges from 3.2 per cent to 10.1 per cent (2016 – 1.8 per cent to 10.1 per cent) and on the Government bonds from 0.8 per cent to 3.4 per cent (2016 – 0.4 per cent to 3.4 per cent).

(b) Credit risk

The Company is exposed to credit risk from default of investments held in its asset portfolio. Management has established policies and guidelines for limiting exposure to credit risk by restricting concentration by issuer, rating, sector and geographic region. At December 31, 2017, investment grade 'A' and higher bonds comprise 93 per cent (2016 – 91 per cent). Government bonds represented 96 per cent (2016 – 95 per cent) of the bond portfolio graded 'A' and above. U.S. Treasury Bonds comprise 100 per cent (2016 – 100 per cent) of the Government bond portfolio. None of the issuers of bonds included in the portfolio has defaulted in interest or principal repayments.

Management believes that the credit risk relating to short-term financial assets which comprise cash and cash equivalents, premium receivables, balances due from related companies and accrued investment income are mitigated by the close monitoring of these balances and by the quality of the financial institutions and insurance companies with which the Company transacts business.

(c) Foreign currency risk

The Company's strategy of matching the currency of its assets with the currency of the liabilities that these assets support results in minimal financial exposure related to foreign currency fluctuations. It is the Company's policy to invest no less than 60 per cent of assets backing its capital and surplus in U.S. dollar denominated assets. As a result, the Company is exposed to foreign currency fluctuations on the remaining balance, however, 100 per cent (2016 – 100 percent) of the assets were denominated in U.S. dollars and therefore changes in foreign currency will not have an impact on earnings.

(d) Underwriting risk

The largest part of the Company's business is providing property catastrophe retrocession protection to clients. The Company, therefore, has a large overall exposure to natural hazards, such as earthquakes, hurricanes, tsunamis, winter storms, floods, fires, tornados and other natural disasters. The underwriting risk stems from the possibility that the frequency and severity of catastrophic events differ from those assumed when pricing the product. The Company manages its exposure to underwriting risk by adhering to conservative pricing and reserving methodology, including peer review by MLI and maintaining clear underwriting guidelines and limits.

(e) Liquidity risk

Liquidity risk is the risk that sufficient funds are not available to meet both expected and unexpected cash and/or collateral demands in a timely and cost-effective manner. Under stressed conditions, unexpected cash demands could arise primarily from the notification of catastrophic losses by ceding companies.

The Company manages its exposure to liquidity risk by maintaining a sufficient proportion of its assets in highly liquid investments and investment grade marketable securities to support its operations and contingent liquidity demands. In addition, the Company sets guidelines on asset allocations, limit structures and maturity profiles of assets in order to ensure sufficient funding is available to meet insurance obligations. Financial liabilities are all due within one year of the statement of financial position.

8. Share Capital

Authorized Share capital:

The Company is authorized to issue an unlimited number of common shares of no par value and cumulative redeemable preferred shares.

	2017			2016		
	Common Shares		Amount	Common Shares		Amount
Balance, beginning of year	190,000	$	190,000	190,000	$	190,000
Issue of shares	200,000		200,000			
Capital reduction			(50,000)			–
Balance, end of year	390,000	$	340,000	190,000	$	190,000

On September 26, 2017 the Company issued 200,000 additional common shares for cash to the existing shareholder. On December 26, 2017, the Company made a remittance to its parent MHBL in the amount of $50,000 in the form of a capital reduction.

9. Taxation

Under the provisions of the Exempt Insurance Act, CAP. 308A, sec 29(2) the Company is liable to tax at eight per cent of the first Barbados dollars ("BBD") 250 (United States dollars equivalent 125) of taxable income and at the rate of zero per cent in respect of all other taxable income in excess of BBD 250 (United States dollars equivalent 125).

10. Net Change in Non-Cash Assets and Liabilities

For the year ended December 31		2017		2016
Net change in non-cash assets and liabilities consists of:				
(Increase) decrease in premiums receivable	$	(22,913)	$	970
Decrease (increase) in accrued investment income		233		(283)
Decrease in balance due from related companies		9		6
(Increase) decrease in other assets		(60,497)		160
(Increase) decrease in loss reserves		216,680		(2,761)
Decrease in unearned premium reserve		(721)		(367)
(Decrease) increase in accounts payable and accrued liabilities		(1,474)		482
(Decrease) increase in balance due to related companies		(120)		109
	$	131,197	$	(1,684)

11. Contingencies

Pursuant to the terms of certain reinsurance contracts, the Company has issued irrevocable letters of credit in the amount of $5,243 (2016 – $204). These letters of credit are intended to provide security to the reinsured parties in the event that the Company is unable to fulfill its obligations under the existing contracts. These letters of credit have no fixed expiration date and are cancellable at the discretion of the holder or upon the cancellation or commutation of the underlying contract.

The Company normally records claims as and when notified by reinsured counterparties. In the ordinary course of business, it is the Company's policy to book reserves relating to such claims in the amount notified by the counterparty. However, from time to time, these claims may be disputed and become the subject of arbitration or other proceedings. In such circumstances, the amount settled may be more or less than the amount reserved and the difference may be material. Management believes that all notified claims have been adequately reserved.

12. Fair Value of Financial Instruments

Financial instruments refer to assets or liabilities which are contracts that ultimately give rise to a right for one party to receive an asset and an obligation for another party to deliver an asset.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either:

i) in the principal market for the asset or liability, or
ii) in the absence of a principal market, in the most advantageous market for the asset or liability.

The principal or the most advantageous market must be accessible by the Company.

The fair value of an asset or a liability is measured using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest.

A fair value measurement of a non-financial asset takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use.

Fair values reflect management's best estimates of the amounts at which instruments could be exchanged in a current transaction between willing parties and are generally calculated based on the characteristics of the instrument and the current economic and competitive environment.

The methods and assumptions used to estimate the fair value of each class of financial instrument for which it is practical to estimate a value are as follows:

(a) Short-term financial assets and liabilities

The cost based carrying value of these assets and liabilities is a reasonable estimate of their fair value because of the short maturity of these instruments. Short-term financial assets comprise cash equivalents, premiums receivable, balance due from related companies and accrued investment income. Short-term financial liabilities comprise accounts payable and accrued liabilities and balance due to related companies.

(b) Investments

The Company categorizes its fair value measurements according to a three-level hierarchy. The hierarchy prioritizes the inputs used by the Company's valuation techniques. A level is assigned to each fair value measurement based on the lowest level input significant to the fair value measurement in its entirety. The three levels of the fair value hierarchy are defined as follows:

Level 1 – Fair value measurements that reflect unadjusted, quoted prices in active markets for identical assets and liabilities that the Company has the ability to access at the measurement date reflecting market transactions.

Level 2 – Fair value measurements using inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. These include quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets and liabilities in inactive markets, inputs that are observable that are not prices (such as interest rates, credit risks, etc.) and inputs that are derived from or corroborated by observable market data. Most bonds are classified within Level 2.

Level 3 – Fair value measurements using significant non-market observable inputs. These include valuations for assets and liabilities that are derived using data, some or all of which is not market observable, including assumptions about risk. Level 3 securities might include less liquid securities including securities that have little or no price transparency.

In determining the fair value of its financial instruments, the Company uses observable market data, when available, and minimizes the use of unobservable inputs to the extent possible.

The following table presents the Company's assets and liabilities that are carried at fair value, by level under the fair value hierarchy:

As at December 31, 2017	Total Fair Value	Level 1	Level 2	Level 3
Bonds - available-for-sale	$ 347,657	$ –	$ 347,657	$ –
As at December 31, 2016				
Bonds - available-for-sale	$ 190,986	$ –	$ 190,149	$ 837

Both the fair value and the basis for determining the fair value of investments are disclosed in Note 4 of these financial statements.

The table below provides a fair value roll-forward for the twelve month periods ending December 31, 2017 and 2016 for the financial instruments for which significant unobservable inputs (Level 3) are used in the fair value measurement. The Company classifies the fair values of financial instruments within Level 3 if there are no observable markets for the instruments or, in the absence of active markets, the majority of the inputs used to determine fair value are based on the Company's own assumptions about market participant assumptions. The Company prioritizes the use of market-based inputs over entity-based assumptions in determining Level 3 fair values and therefore, the gains and losses in the tables below include changes in fair value due partly to observable and unobservable factors.

Roll-forward of financial instruments measured at fair value using significant unobservable inputs (Level 3):

Bonds - available-for-sale	2017	2016
Balance, beginning of year	$ 837	$ 857
Other comprehensive loss [1]	(27)	(19)
Net income	(1)	(1)
Transfers out of Level 3	(809)	–
Balance, end of year	$ –	$ 837

(1) These amounts are included in accumulated other comprehensive (loss) income on the Statement of Changes in Equity.

13. Stock-Based Compensation

MFC's Global Share Ownership Plan ("GSOP") allows qualifying employees to choose to apply up to five per cent of their annual base earnings toward the purchase of common shares. The Company matches a percentage of the employee's eligible contributions up to a maximum amount. All contributions are used to purchase common shares in the open market. The Company has made contributions in the amount of $5 (2016 - $4).

14. Capital Management

The Company's policy is to maintain a strong capital base by routinely monitoring its capital adequacy from a Barbados solvency requirement and other insurance standards where appropriate. The Company employs risk based capital requirements, to ensure that the Company is able to absorb losses due to underpricing of the reinsurance product; to absorb an unexpected decline in the value of Company's assets; to provide a buffer for the potential undervaluation of the Company's unpaid claim liabilities and to provide a mechanism for financing the growth of the Company.

The Company is incorporated under the Barbados Companies Act CAP. 308 and operates under the provisions of the Exempt Insurance Act, CAP. 308A. Under the latter the Company is required to comply with certain minimum capital and solvency criteria. The Company complied with all external regulatory requirements during the current and previous financial years.

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About Manulife

Manulife Financial Corporation is a leading international financial services group that helps people make their decisions easier and lives better. We operate primarily as John Hancock in the United States and Manulife elsewhere. We provide financial advice, insurance, as well as wealth and asset management solutions for individuals, groups and institutions. At the end of 2017, we had approximately 34,000 employees, 73,000 agents, and thousands of distribution partners, serving more than 26 million customers. As of December 31, 2017, we had over $1.04 trillion (US$829.4 billion) in assets under management and administration, and in the previous 12 months we made $26.7 billion in payments to our customers. Our principal operations are in Asia, Canada and the United States where we have served customers for more than 100 years. With our global headquarters in Toronto, Canada, we trade as 'MFC' on the Toronto, New York, and the Philippine stock exchanges and under '945' in Hong Kong.