Manulife Re™

2014 Annual Report
Manufacturers P&C Limited

strong reliable trustworthy forward-thinking

Auditors' Report

To the shareholder of Manufacturers P&C Limited

We have audited the accompanying financial statements of Manufacturers P&C Limited which comprise of the statement of financial position as at December 31, 2014 and the related statements of income, comprehensive income, changes in equity and cash flows for the year then ended and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements
Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards, 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 and error.

Auditors' Responsibility
Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider internal control relevant to the entity's preparation and fair presentation of the 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. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence that we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion
In our opinion, the financial statements present fairly, in all material respects, the financial position of Manufacturers P&C Limited as at December 31, 2014 and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Ernst + Young

CHARTERED ACCOUNTANTS
March 13, 2015
Barbados

STATEMENT OF FINANCIAL POSITION

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

	2014	2013
ASSETS		
Cash and cash equivalents (Note 5)	$ 125,548	$ 191,282
Investments (Note 4)	228,350	231,507
Premiums receivable	1,565	16,762
Accrued investment income	1,058	1,301
Capital assets, net of accumulated depreciation	764	848
Other assets	834	568
Balance due from related company (Note 5)	94	–
	$ 358,213	$ 442,268
LIABILITIES		
Loss reserves (Note 6)	$ 4,409	$ 52,058
Unearned premium reserve	6,217	9,116
Accounts payable and accrued liabilities	4,409	5,136
Balance due to related companies (Note 5)	96	75
	$ 15,131	$ 66,385
SHAREHOLDER'S EQUITY		
Share capital (Note 8)	$ 190,000	$ 190,000
Contributed surplus (Note 8)	20,000	20,000
Retained earnings	120,604	172,902
Accumulated other comprehensive income (loss)	12,478	(7,019)
	$ 343,082	$ 375,883
	$ 358,213	$ 442,268

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

Claudio Macchi
Director

Steve Roder
Director

STATEMENT OF INCOME

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

		2014		2013
Revenue				
Reinsurance premiums written (Note 6)	$	65,078	$	77,297
Change in unearned premium reserve		2,899		695
Reinsurance premiums earned		67,977		77,992
Investment income (Note 4)		6,298		3,056
Unrealized foreign exchange gain		–		7
	$	74,275	$	81,055
Expenses				
Losses recovered (Note 6)	$	(133)	$	(9,692)
Commissions and brokerage		1,929		1,280
General and administrative expenses		4,777		4,477
	$	6,573		(3,935)
Net income	$	67,702		84,990

STATEMENT OF COMPREHENSIVE INCOME

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

		2014		2013
Net income	$	67,702	$	84,990
Other comprehensive income (loss):				
Unrealized gain (loss) on investments		19,497		(17,505)
Total comprehensive income	$	87,199	$	67,485

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

STATEMENT OF CHANGES IN EQUITY

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

	2014	2013
Common shares		
Balance, beginning and end of year	$ 190,000	$ 190,000
Contributed surplus		
Balance, beginning and end of year	$ 20,000	$ 20,000
Retained earnings		
Balance, beginning of year	$ 172,902	$ 87,912
Net income	67,702	84,990
Common share dividends (2014 - $0.63 per share; 2013 - NIL)	(120,000)	–
Balance, end of year	$ 120,604	$ 172,902
Accumulated other comprehensive income (loss)		
Balance, beginning of year	$ (7,019)	$ 10,486
Other comprehensive income (loss)	19,497	(17,505)
Balance, end of year	$ 12,478	$ (7,019)
Total equity	$ 343,082	$ 375,883

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

STATEMENT OF CASH FLOWS

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

	2014	2013
Operating activities		
Net income	$ 67,702	$ 84,990
Adjustment for non-cash items:		
Depreciation of capital assets	136	95
Unrealized foreign exchange gain	–	(7)
(Amortization) discount on bonds	(28)	343
(Gain) loss on sale of investments	(244)	3,820
Gain on sale of capital assets	(50)	(27)
Net income adjusted for non-cash items	67,516	89,214
Net change in non-cash assets and liabilities (Note 10)	(36,174)	(5,382)
Cash provided by operating activities	$ 31,342	$ 83,832
Investing activities		
Net purchase of capital assets	$ (3)	$ (738)
Purchase of investments	(495)	(128,932)
Proceeds from the sale and maturity of investments	23,422	148,747
Cash provided by investing activities	$ 22,924	$ 19,077
Financing activities		
Shareholder dividends paid in cash	$ (120,000)	$ –
Cash used in financing activities	$ (120,000)	$ –
Cash and cash equivalents		
(Decrease) increase during the year	$ (65,734)	$ 102,909
Balance, beginning of year	191,282	88,373
Balance, end of year	$ 125,548	$ 191,282
Supplemental disclosures on cash flow information:		
Interest received	$ 6,269	$ 8,587

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

NOTES TO THE FINANCIAL STATEMENTS

December 31, 2014
(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 stock insurance 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, 2014 were authorized for issue in accordance with a resolution of the directors on March 13, 2015.

2. Significant Accounting Policies

These financial statements are prepared in accordance with International Financial Reporting Standards ("IFRS"). 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 as at the date of the financial statements, and the reported amounts of revenue and expenses during the reporting period. 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. 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, assets held in liquidity pools and short-term deposits, which have an original term to maturity of three months or less from the original acquisition date.

(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, which are classified as available-for-sale, are measured at fair value. Changes in fair value are recorded in other comprehensive income ("OCI") 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 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 counterparty, 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 the 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 and is 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.

(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 for the remainder of its term, even if the insurance risk reduces significantly during this period, unless all rights and obligations are extinguished or expire.

(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 rates of exchange in effect at the statement of financial position date. Revenue and expenses are translated at the average rates of exchange 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 distress 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 plans provide pension benefits based on the accumulated contributions and fund earnings. The cost of defined contribution plans is the contribution provided by the Company. Contributions to defined contribution pension plans are 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 2014 and those that will become effective subsequently, are presented below:

(a) Changes in accounting polices

(i) Amendments to IAS 32 "Financial Instruments: Presentation"

Effective January 1, 2014, the Company adopted the amendments to IAS 32 "Offsetting Financial Assets and

Financial Liabilities" issued by the IASB in December 2011. The amendments clarify the basis for offsetting financial instruments presented in the statement of financial position. The adoption of these amendments did not have a significant impact on the Company's financial statements.

(ii) Annual Improvements 2010–2012 and 2011–2013 Cycles

Annual Improvements 2010-2012 and 2011-2013 Cycles were issued in December 2013 and are effective for years beginning on or after July 1, 2014. The IASB issued ten minor amendments to different standards as part of the Annual Improvements process, with some amendments to be applied prospectively and others to be applied retrospectively. Adoption of the amendments which are applicable for the Company is not expected to have a significant impact on the Company's financial statements.

(b) Future accounting and reporting changes

(i) Amendments to IAS 1 "Presentation of Financial Statements"

Amendments to IAS 1 "Presentation of Financial Statements" were issued in December 2014 and are effective for years beginning on or after January 1, 2016. The amendments clarify existing requirements relating to materiality and aggregation, along with presentation of subtotals in the financial statements. Adoption of these amendments is not expected to have a significant impact on the Company's financial statements.

(ii) 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. It 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, revisions have been made in the accounting for changes in fair value of a financial liability 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 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. They also address the income statement accounting mismatches and short-term volatility issues which have been identified as a result of the insurance contracts project. The Company is assessing the impact of these amendments.

(iii) Amendments to IAS 16 "Property, Plant and Equipment" and IAS 38 "Intangible Assets"

Amendments to IAS 16 "Property, Plant and Equipment" and IAS 38 "Intangible Assets" were issued in May 2014 and are effective for years beginning on or after January 1, 2016, to be applied prospectively. The amendments clarify that the depreciation or amortization of assets accounted for under these two standards should reflect a pattern of consumption of the assets rather than reflect economic benefits expected to be generated from the assets. The Company is assessing the impact of these amendments.

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

IFRS 15 "Revenue from Contracts with Customers" was issued in May 2014 and is effective for years beginning on or after January 1, 2017, to be applied retrospectively or on a modified retrospective basis. 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 other related contractual rights and obligations and lease contracts. Accordingly, the adoption of IFRS 15 may impact the revenue recognition related to the Company's asset management and service contracts and will result in additional financial statement disclosure. The Company is currently assessing the impact of this standard.

(v) Annual Improvements 2012–2014 Cycle

Annual Improvements 2012–2014 Cycle was issued in September 2014 and is effective for years beginning on or after January 1, 2016. The IASB issued five minor amendments to different standards as part of the Annual Improvements process, with some amendments to be applied prospectively and others to be applied retrospectively. Adoption of these amendments is not expected to have a significant impact on the Company's financial statements.

4. Investments

(a) Invested assets

For the year ended December 31	Term to Maturity		2014 Carrying Value		2013 Carrying Value
Government bonds	<1 year	$	8,202	$	–
	1-5 years		63,545		77,272
	> 5 years		106,698		86,474
			178,445		163,746
Corporate bonds	<1 year		8,907		11,449
	1-5 years		32,389		36,422
	> 5 years		8,609		19,890
			49,905		67,761
Total		$	228,350	$	231,507

Since all securities are classified as available-for-sale, investments are carried at their fair values as at December 31, 2014. 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		2014		2013
Interest Income	$	6,026	$	7,220
Amortization of premiums on bonds		28		(344)
Gain (loss) on sale of investments		244		(3,820)
	$	6,298	$	3,056

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) Balance due from related company

The balance due from related company of $94 (2013 - NIL) represents a refund from John Hancock Life Insurance Company (U.S.A.) for services provided.

(b) Balance due to related companies

For the year ended December 31		2014		2013
John Hancock Life Insurance Company (U.S.A.)	$	73	$	75
Manufacturers Life Insurance Company		23		-
	$	96	$	75

(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 $123,544 (2013 - $189,952) and is included in cash and cash equivalents of $125,548 (2013 - $191,282). No interest was earned during 2014 (2013 – NIL).

(d) General and administrative expenses

Included in general and administrative expenses is an amount of $865 (2013 - $740), 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		2014		2013
Short-term employee benefits	$	1,916	$	1,722
Pension contribution		53		49
	$	1,969	$	1,771

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		2014		2013
Balance, beginning of the year	$	52,058	$	62,182
Losses recovered relating to contracts written in:				
Prior year		(133)		(9,692)
Total losses recovered		(133)		(9,692)
Losses paid relating to contracts written in:				
Prior year		(47,516)		(432)
Total losses paid		(47,516)		(432)
Balance, end of the year	$	4,409	$	52,058

As discussed in Note 7(d), the Company is exposed to losses arising from catastrophic events. After a catastrophic event occurs, loss reserves are estimated by management through analysis of contracts which may be exposed to the event. The in-depth analysis generally involves an assessment of industry losses for the event and an assessment of the impact of the event on reinsured counter parties through discussions with, and by review of information reported by, the counter parties. Losses are assessed both on an individual basis and in the aggregate. The amounts reserved are sensitive to the assessment of the severity of an insured event and, therefore, losses may be settled for amounts lesser or greater than reported, and the difference may be material.

During 2013 the Company released the reserve for Hurricane Sandy of $10,000 and related reinstatement premium receivable of $2,900 which was established in 2012.

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

For the year ended December 31		2014		2013
Gross premiums	$	65,078	$	80,135
Reinstatement premiums		–		(2,838)
Reinsurance premiums written	$	65,078	$	77,297

7. Risk Management

The Company employs an enterprise-wide approach to all risk taking and risk management activities globally. 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, 2014	**+100bps**	**-100bps**
Invested assets	$ (28,523)	$ 35,163
As at December 31, 2013		
Invested assets	$ (20,834)	$ 24,631

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 1.8 per cent to 9.8 per cent (2013 – 1.8 per cent to 10.0 per cent) and on the Government bonds from 0.3 per cent to 4.5 per cent (2013 – 0.3 per cent to 5.0 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.

Investment grade 'A' and higher bonds comprise 87 per cent (2013 – 79 per cent). Government bonds represented 90 per cent (2013 – 89 per cent) of the bond portfolio graded 'A' and above. U.S. Treasury Bonds comprise 99 per cent (2013 – 99 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 of cash and short-term securities, premium receivables 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 whom 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. dollars-denominated assets. As a result, the Company is exposed to foreign currency fluctuations on the remaining balance, however, 100 per cent (2013 – 100 percent) of the assets were denominated in U.S. dollars and therefore changes in foreign currency will not have a significant 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 portfolio, 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 and Contributed Surplus

(a) Share capital

	2014		2013	
	Number of Common Shares	Value	Number of Common Shares	Value
Balance, beginning and end of year	190,000	$ 190,000	190,000	$ 190,000

The authorized capital of the Company consists of an unlimited number of common shares and cumulative redeemable preferred shares.

(b) Contributed surplus

The Directors of the Company may agree to return any part of the contributed surplus to MHBL, the shareholder, if they determine that the shareholder's equity is in excess of the Company's needs.

9. Taxation

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

10. Net Change in Non-Cash Assets and Liabilities

For the year ended December 31		2014		2013
Net change in non-cash assets and liabilities consists of:				
Decrease in premium receivable	$	15,197	$	2,562
Decrease in accrued investment income		243		1,367
Increase in balance due from related company		(94)		–
Increase in other assets		(266)		(172)
Decrease in loss reserves		(47,649)		(10,124)
Decrease in unearned premium reserve		(2,899)		(694)
(Decrease) increase in accounts payable and accrued liabilities		(727)		1,706
Increase (decrease) in balance due to related companies		21		(27)
	$	(36,174)	$	(5,382)

11. Contingencies

Pursuant to the terms of certain reinsurance contracts, the Company has issued irrevocable letters of credit in the amount of $1,374 (2013 – $1,386). 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 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 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 and short-term securities, premiums receivable and accrued investment income. Short-term financial liabilities comprise accounts payable and balance due to related party.

(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. Valuations are based on quoted prices reflecting market transactions involving assets or liabilities identical to those being measured.

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.

Valuations based on non-market observable inputs are based on best estimates from subject experts in the field.

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, 2014

	Total Fair Value	Level 1	Level 2	Level 3
Bonds - available-for-sale	$ 228,350	–	$ 226,945	$ 1,405

As at December 31, 2013

	Total Fair Value	Level 1	Level 2	Level 3
Bonds - available-for-sale	$ 231,507	–	$ 230,062	$ 1,445

Both the fair value and the basis for determining the fair value of investments are disclosed in Note 4 of these financial statements. There were no transfers between the levels during the year.

The table below provides a fair value roll forward for the twelve months ending December 31, 2014 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	2014	2013
Balance, beginning of year	$ 1,445	$ 2,552
Other comprehensive loss[1]	(41)	(98)
Net income (loss)	1	(9)
Settlements	–	(1,000)
Balance, end of year	$ 1,405	$ 1,445

(1) This amount is included in accumulated other comprehensive 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 percent 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 (2013 - $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, such as those developed by modern statistical modeling techniques, 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 of Barbados, 1983 CAP. 308A. Under the latter the Company is required to comply with certain minimum capital and solvency criteria. The Company complied with all such requirements during the current and previous financial years.

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Manulife is a leading Canada-based financial services group with principal operations in Asia, Canada and the United States. We operate as John Hancock in the U.S. and as Manulife in other parts of the world. We provide strong, reliable, trustworthy and forward-thinking solutions for our customers' significant financial decisions. Our international network of employees, agents and distribution partners offers financial protection and wealth management products and services to millions of clients. We also provide asset management services to institutional customers. Assets under management by Manulife and its subsidiaries were approximately C$691 billion (US$596 billion) as at December 31, 2014.

Manulife Financial Corporation trades as 'MFC' on the TSX, NYSE and PSE, and under '945' on the SEHK. Manulife can be found on the Internet at manulife.com.