Enstar Group LTD
Form 10-Q
August 03, 2017

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2017
Commission File Number 001-33289

ENSTAR GROUP LIMITED
(Exact name of Registrant as specified in its charter)

| | |
|---|---|
| BERMUDA | N/A |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |

Windsor Place, 3rd Floor, 22 Queen Street, Hamilton HM JX, Bermuda
(Address of principal executive offices, including zip code)

Registrant’s telephone number, including area code: (441) 292-3645

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes þ No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company” and "emerging growth company" in Rule 12b-2 of the Exchange Act.

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Large accelerated filer | þ | Accelerated filer | ¨ | Non-accelerated filer | ¨ | Smaller reporting company | ¨ | Emerging growth company | ¨ |

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ¨
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No þ
As of August 2, 2017, the registrant had outstanding 16,421,611 voting ordinary shares and 3,004,443 non-voting convertible ordinary shares, each par value $1.00 per share.

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Enstar Group Limited
Quarterly Report on Form 10-Q
For the Period Ended June 30, 2017

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PART I — FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS
ENSTAR GROUP LIMITED
UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS
As of June 30, 2017 and December 31, 2016

| | June 30, 2017 | December 31, 2016 |
|---|---|---|
| | (expressed in thousands of U.S. dollars, except share data) | |
| ASSETS | | |
| Short-term investments, trading, at fair value | $ 327,595 | $ 222,918 |
| Short-term investments, available-for-sale, at fair value (amortized cost: 2017 — $nil; 2016 — $287) | — | 268 |
| Fixed maturities, trading, at fair value | 5,644,098 | 4,388,242 |
| Fixed maturities, available-for-sale, at fair value (amortized cost: 2017 — $228,762; 2016 — $269,577) | 228,771 | 267,499 |
| Equities, trading, at fair value | 106,240 | 95,047 |
| Other investments, at fair value | 890,943 | 937,047 |
| Other investments, at cost | 128,296 | 131,651 |
| Total investments | 7,325,943 | 6,042,672 |
| Cash and cash equivalents | 681,068 | 954,871 |
| Restricted cash and cash equivalents | 423,683 | 363,774 |
| Funds held - directly managed | 1,205,592 | 994,665 |
| Premiums receivable | 443,201 | 406,676 |
| Deferred tax assets | 13,988 | 11,374 |
| Prepaid reinsurance premiums | 247,901 | 219,115 |
| Reinsurance balances recoverable | 1,477,433 | 1,460,743 |
| Reinsurance balances recoverable, at fair value | 554,759 | — |
| Funds held by reinsured companies | 84,073 | 82,073 |
| Deferred acquisition costs | 76,643 | 58,114 |
| Goodwill and intangible assets | 182,504 | 184,855 |
| Other assets | 851,227 | 842,356 |
| Assets held for sale | 1,262,756 | 1,244,456 |
| TOTAL ASSETS | $ 14,830,771 | $ 12,865,744 |
| | | |
| LIABILITIES | | |
| Losses and loss adjustment expenses | $ 5,749,087 | $ 5,987,867 |
| Losses and loss adjustment expenses, at fair value | 1,892,297 | — |
| Policy benefits for life and annuity contracts | 114,727 | 112,095 |
| Unearned premiums | 588,082 | 548,343 |
| Insurance and reinsurance balances payable | 470,055 | 394,021 |
| Deferred tax liabilities | 22,393 | 28,356 |
| Debt obligations | 640,787 | 673,603 |
| Other liabilities | 781,494 | 705,318 |
| Liabilities held for sale | 1,142,560 | 1,150,787 |
| TOTAL LIABILITIES | 11,401,482 | 9,600,390 |
| | | |
| COMMITMENTS AND CONTINGENCIES | | |

| | | |
|---|---|---|
| REDEEMABLE NONCONTROLLING INTEREST | 457,646 | 454,522 |
| SHAREHOLDERS’ EQUITY | | |
| Share capital authorized, issued and fully paid, par value $1 each (authorized 2017 and 2016: 156,000,000): | | |
| Ordinary shares (issued and outstanding 2017: 16,385,570; 2016: 16,175,250) | 16,386 | 16,175 |
| Non-voting convertible ordinary shares: | | |
| Series C (issued and outstanding 2017: 2,599,672; 2016: 2,792,157) | 2,600 | 2,792 |
| Series E (issued and outstanding 2017: 404,771; 2016: 404,771) | 405 | 405 |
| Series C Preferred Shares (issued 2017: 388,571; 2016: 388,571) | 389 | 389 |
| Treasury shares at cost (Preferred shares 2017: 388,571; 2016: 388,571) | (421,559) | (421,559) |
| Additional paid-in capital | 1,386,332 | 1,380,109 |
| Accumulated other comprehensive loss | (18,611) | (23,549) |
| Retained earnings | 1,996,283 | 1,847,550 |
| Total Enstar Group Limited Shareholders’ Equity | 2,962,225 | 2,802,312 |
| Noncontrolling interest | 9,418 | 8,520 |
| TOTAL SHAREHOLDERS’ EQUITY | 2,971,643 | 2,810,832 |
| TOTAL LIABILITIES, REDEEMABLE NONCONTROLLING INTEREST AND SHAREHOLDERS’ EQUITY | $ 14,830,771 | $ 12,865,744 |

See accompanying notes to the unaudited condensed consolidated financial statements

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ENSTAR GROUP LIMITED
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS
For the Three and Six Months Ended June 30, 2017 and 2016

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2017 | 2016 | 2017 | 2016 |
| | (expressed in thousands of U.S. dollars, except share and per share data) | | | |
| INCOME | | | | |
| Net premiums earned | $155,571 | $208,709 | $304,469 | $401,596 |
| Fees and commission income | 18,667 | 10,487 | 30,581 | 16,911 |
| Net investment income | 49,417 | 44,932 | 98,156 | 95,212 |
| Net realized and unrealized gains | 51,877 | 34,503 | 110,396 | 72,780 |
| Other income | 10,856 | 3,289 | 23,054 | 5,699 |
| | 286,388 | 301,920 | 566,656 | 592,198 |
| EXPENSES | | | | |
| Net incurred losses and loss adjustment expenses | 9,620 | 96,462 | 87,512 | 179,680 |
| Life and annuity policy benefits | 4,289 | (1,613) | 3,988 | (1,455) |
| Acquisition costs | 30,355 | 43,847 | 51,176 | 88,876 |
| General and administrative expenses | 106,490 | 104,206 | 208,958 | 197,140 |
| Interest expense | 7,573 | 5,421 | 14,441 | 10,819 |
| Net foreign exchange losses (gains) | 7,122 | (1,856) | 10,837 | (84) |
| Loss on sale of subsidiary | 9,609 | — | 9,609 | — |
| | 175,058 | 246,467 | 386,521 | 474,976 |
| EARNINGS BEFORE INCOME TAXES | 111,330 | 55,453 | 180,135 | 117,222 |
| INCOME TAXES | (4,731) | (8,050) | (1,802) | (15,419) |
| NET EARNINGS FROM CONTINUING OPERATIONS | 106,599 | 47,403 | 178,333 | 101,803 |
| NET EARNINGS (LOSSES) FROM DISCONTINUED OPERATIONS, NET OF INCOME TAX EXPENSE | (4,871) | 2,378 | (4,500) | 2,583 |
| NET EARNINGS | 101,728 | 49,781 | 173,833 | 104,386 |
| Less: Net earnings attributable to noncontrolling interest | (11,542) | (9,187) | (28,967) | (18,272) |
| NET EARNINGS ATTRIBUTABLE TO ENSTAR GROUP LIMITED | $90,186 | $40,594 | $144,866 | $86,114 |
| | | | | |
| Earnings per ordinary share attributable to Enstar Group Limited: | | | | |
| Basic: | | | | |
| Net earnings from continuing operations | $4.90 | $1.98 | $7.71 | $4.33 |
| Net earnings (losses) from discontinued operations | (0.25) | 0.12 | (0.23) | 0.13 |
| Net earnings per ordinary share | $4.65 | $2.10 | $7.48 | $4.46 |
| Diluted: | | | | |
| Net earnings from continuing operations | $4.87 | $1.97 | $7.66 | $4.30 |
| Net earnings (losses) from discontinued operations | (0.25) | 0.12 | (0.23) | 0.13 |
| Net earnings per ordinary share | $4.62 | $2.09 | $7.43 | $4.43 |
| Weighted average ordinary shares outstanding: | | | | |
| Basic | 19,387,650 | 19,295,280 | 19,381,225 | 19,289,119 |
| Diluted | 19,511,429 | 19,430,464 | 19,506,077 | 19,420,541 |

See accompanying notes to the unaudited condensed consolidated financial statements

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ENSTAR GROUP LIMITED
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
For the Three and Six Months Ended June 30, 2017 and 2016

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2017 | 2016 | 2017 | 2016 |
| | (expressed in thousands of U.S. dollars) | | | |
| NET EARNINGS | $101,728 | $49,781 | $173,833 | $104,386 |
| Other comprehensive income, net of tax: | | | | |
| Unrealized holding gains on fixed income investments arising during the period | 1,693 | 2,400 | 2,379 | 9,364 |
| Reclassification adjustment for net realized gains included in net earnings | (102) | (113) | (251) | (135) |
| Unrealized gains arising during the period, net of reclassification adjustment | 1,591 | 2,287 | 2,128 | 9,229 |
| Currency translation adjustment | 2,315 | (4,542) | 4,257 | 6,053 |
| Total other comprehensive income (loss) | 3,906 | (2,255) | 6,385 | 15,282 |
| Comprehensive income | 105,634 | 47,526 | 180,218 | 119,668 |
| Less: Comprehensive income attributable to noncontrolling interest | (12,333) | (9,353) | (30,415) | (19,919) |
| COMPREHENSIVE INCOME ATTRIBUTABLE TO ENSTAR GROUP LIMITED | $93,301 | $38,173 | $149,803 | $99,749 |

See accompanying notes to the unaudited condensed consolidated financial statements

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ENSTAR GROUP LIMITED
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
For the Six Months Ended June 30, 2017 and 2016

| | Six Months Ended June 30, 2017 | 2016 |
|---|---|---|
| | (expressed in thousands of U.S. dollars) | |
| Share Capital — Ordinary Shares | | |
| Balance, beginning of period | $ 16,175 | $ 16,133 |
| Issue of shares | 19 | 34 |
| Conversion of Series C Non-Voting Convertible Ordinary Shares | 192 | — |
| Balance, end of period | $ 16,386 | $ 16,167 |
| Share Capital — Series A Non-Voting Convertible Ordinary Shares | | |
| Balance, beginning of period | $ — | $ 2,973 |
| Shares converted to Series C Convertible Participating Non-Voting Perpetual Preferred Stock | — | (2,973) |
| Balance, end of period | $ — | $ — |
| Share Capital — Series C Non-Voting Convertible Ordinary Shares | | |
| Balance, beginning of period | $ 2,792 | $ 2,726 |
| Conversion to Ordinary Shares | (192) | — |
| Balance, end of period | $ 2,600 | $ 2,726 |
| Share Capital — Series E Non-Voting Convertible Ordinary Shares | | |
| Balance, beginning and end of period | $ 405 | $ 405 |
| Share Capital — Series C Convertible Participating Non-Voting Perpetual Preferred Stock | | |
| Balance, beginning of period | $ 389 | $ — |
| Conversion of Series A Non-Voting Convertible Ordinary Stock | — | 389 |
| Balance, beginning and end of period | $ 389 | $ 389 |
| Treasury Shares | | |
| Balance, beginning and end of period | $ (421,559) | $ (421,559) |
| Additional Paid-in Capital | | |
| Balance, beginning of period | $ 1,380,109 | $ 1,373,044 |
| Issue of shares and warrants | 66 | 360 |
| Conversion of Series A Non-Voting Convertible Ordinary Stock | — | 2,584 |
| Amortization of equity incentive plan | 6,157 | 602 |
| Balance, end of period | $ 1,386,332 | $ 1,376,590 |
| Accumulated Other Comprehensive Loss | | |
| Balance, beginning of period | $ (23,549) | $ (35,162) |
| Currency translation adjustment | | |
| Balance, beginning of period | (18,993) | (23,790) |
| Change in currency translation adjustment | 4,253 | 6,053 |
| Balance, end of period | (14,740) | (17,737) |
| Defined benefit pension liability | | |
| Balance, beginning and end of period | (4,644) | (7,723) |
| Unrealized gains (losses) on investments | | |
| Balance, beginning of period | 88 | (3,649) |
| Change in unrealized gains (losses) on investments | 685 | 7,582 |
| Balance, end of period | 773 | 3,933 |

| | | |
|---|---|---|
| Balance, end of period | $ (18,611) | $ (21,527) |
| Retained Earnings | | |
| Balance, beginning of period | $ 1,847,550 | $ 1,578,312 |
| Net earnings attributable to Enstar Group Limited | 144,866 | 86,114 |
| Accretion of redeemable noncontrolling interests to redemption value | (1,015) | (1,803) |
| Cumulative effect of change in accounting principle | 4,882 | — |
| Balance, end of period | $ 1,996,283 | $ 1,662,623 |
| Noncontrolling Interest (excludes Redeemable Noncontrolling Interest) | | |
| Balance, beginning of period | $ 8,520 | $ 3,911 |
| Net earnings attributable to noncontrolling interest | 898 | (270) |
| Balance, end of period | $ 9,418 | $ 3,641 |

See accompanying notes to the unaudited condensed consolidated financial statements

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ENSTAR GROUP LIMITED

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Six Months Ended June 30, 2017 and 2016

| | Six Months Ended June 30, | |
|---|---|---|
| | 2017 | 2016 |
| | (expressed in thousands of U.S. dollars) | |
| OPERATING ACTIVITIES: | | |
| Net earnings | $173,833 | $104,386 |
| Net losses (earnings) from discontinued operations | 4,500 | (2,583) |
| Adjustments to reconcile net earnings to cash flows used in operating activities: | | |
| Net realized (gains) losses on sale of investments | (74) | (747) |
| Net unrealized (gains) on investments | (88,304) | (72,033) |
| Other non-cash items | 5,352 | 3,811 |
| Depreciation and other amortization | 18,797 | 18,833 |
| Net change in trading securities held on behalf of policyholders | 25,597 | (996) |
| Sales and maturities of trading securities | 2,225,349 | 1,633,179 |
| Purchases of trading securities | (3,616,862) | (1,546,895) |
| Net loss on sale of subsidiary | 9,609 | — |
| Changes in: | | |
| Reinsurance balances recoverable | (570,731) | 131,841 |
| Funds held by reinsured companies | (212,927) | (1,081,542) |
| Losses and loss adjustment expenses | 1,646,721 | 701,414 |
| Policy benefits for life and annuity contracts | 64 | (6,534) |
| Insurance and reinsurance balances payable | 75,890 | 42,715 |
| Unearned premiums | 39,739 | 34,200 |
| Other operating assets and liabilities | 898 | (143,086) |
| Net cash flows used in operating activities | (262,549) | (184,037) |
| INVESTING ACTIVITIES: | | |
| Acquisitions, net of cash acquired | — | 9,924 |
| Sales and maturities of available-for-sale securities | 45,932 | 55,443 |
| Purchase of available-for-sale securities | (162) | (47,798) |
| Purchase of other investments | (67,516) | (18,230) |
| Redemption of other investments | 152,650 | 77,971 |
| Other investing activities | (9,708) | (1,597) |
| Net cash flows provided by investing activities | 121,196 | 75,713 |
| FINANCING ACTIVITIES: | | |
| Dividends paid to noncontrolling interest | (27,458) | — |
| Receipt of loans | 489,100 | 154,048 |
| Repayment of loans | (528,500) | (140,500) |
| Net cash flows provided by (used in) financing activities | (66,858) | 13,548 |
| EFFECT OF EXCHANGE RATE CHANGES ON FOREIGN CURRENCY CASH AND CASH EQUIVALENTS | 636 | 451 |
| NET DECREASE IN CASH AND CASH EQUIVALENTS | (207,575) | (94,325) |
| CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD | 1,318,645 | 1,295,169 |
| CHANGE IN CASH OF BUSINESSES HELD FOR SALE | (6,319) | — |

| | | |
|---|---|---|
| CASH AND CASH EQUIVALENTS, END OF PERIOD | $1,104,751 | $1,200,844 |
| | | |
| Supplemental Cash Flow Information: | | |
| Income taxes paid, net of refunds | $6,538 | $15,830 |
| Interest paid | $8,959 | $10,578 |
| | | |
| Reconciliation to Consolidated Balance Sheets: | | |
| Cash and cash equivalents | 681,068 | 759,584 |
| Restricted cash and cash equivalents | 423,683 | 441,260 |
| Cash, cash equivalents and restricted cash | $1,104,751 | $1,200,844 |

See accompanying notes to the unaudited condensed consolidated financial statements

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ENSTAR GROUP LIMITED
NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2017 and December 31, 2016

(Tabular information expressed in thousands of U.S. dollars except share and per share data)

## 1. SIGNIFICANT ACCOUNTING POLICIES

### Basis of Preparation and Consolidation

These unaudited condensed consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America ("U.S. GAAP") for interim financial information. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. In the opinion of management, these financial statements reflect all adjustments consisting of normal recurring items considered necessary for a fair presentation under U.S. GAAP. The results of operations for any interim period are not necessarily indicative of results of the full year. These financial statements should be read in conjunction with the consolidated financial statements and related notes included in our Annual Report on Form 10-K for the year ended December 31, 2016. All significant inter-company transactions and balances have been eliminated. Results of operations for acquired subsidiaries are included from the date of acquisition. In these notes, the terms "we," "us," "our," or "the Company" refer to Enstar Group Limited and its consolidated subsidiaries. Certain prior period amounts have been reclassified to conform to the current period presentation. These reclassifications had no impact on net earnings.

The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results may differ materially from these estimates. Results of changes in estimates are reflected in earnings in the period in which the change is made. Our principal estimates include, but are not limited to:

- liability for losses and loss adjustment expenses ("LAE");
- liability for policy benefits for life and annuity contracts;
- reinsurance balances recoverable;
- gross and net premiums written and net premiums earned;
- impairment charges, including other-than-temporary impairments on investment securities classified as available-for-sale or held-to-maturity, and impairments on goodwill, intangible assets and deferred charges;
- fair value measurements of investments;
- fair value estimates associated with accounting for acquisitions;
- fair value estimates associated with loss portfolio transfer reinsurance agreements for which we have elected the fair value option; and
- redeemable noncontrolling interests.

### Significant New Accounting Policies

As a result of electing the fair value option in relation to the two new transactions described in Note 2 - "Significant New Business", we adopted a significant new accounting policy during the six months ended June 30, 2017. Other than the policy described below, there have been no material changes to the Company’s significant accounting policies from those described in Note 2 - "Significant Accounting Policies" to the consolidated financial statements contained in our Annual Report on Form 10-K for the year ended December 31, 2016.

Retroactive Reinsurance - Fair Value Option

In our Non-life Run-off segment we have elected to apply the fair value option for certain loss portfolio transfer reinsurance transactions. This is an irrevocable election that applies to all balances under the insurance contract, including funds held assets, reinsurance recoverable, and the liability for losses and loss adjustment expenses.

The Company uses an internal model to calculate the fair value of the liability for losses and loss adjustment expenses and reinsurance recoverable asset. Note 6 - "Fair Value Measurements" describes the internal model, including the observable and unobservable inputs used in the model.

New Accounting Standards Adopted in 2017

Accounting Standards Update ("ASU") 2017-08, Premium Amortization on Purchased Callable Debt Securities

In March 2017, the Financial Accounting Standards Board ("FASB") issued ASU 2017-08, which amends the amortization period for certain purchased callable debt securities held at a premium, shortening such period to the earliest call date. The adoption of this guidance did not have a material impact on our consolidated financial statements.

ASU 2016-09, Improvements to Employee Share-Based Payment Accounting

In March 2016, the FASB issued ASU 2016-09, which simplifies several aspects of the accounting for employee share-based payment transactions, including the accounting for income taxes, forfeitures, and statutory tax withholding requirements, as well as classification in the statement of cash flows. The impact of adopting this guidance on our consolidated financial statements was a cumulative-effect adjustment of $4.9 million to opening retained earnings for the excess tax benefit not previously recognized.

ASU 2016-07, Simplifying the Transition to the Equity Method of Accounting

In March 2016, the FASB issued ASU 2016-07, which simplifies the equity method of accounting by eliminating the requirement to retrospectively apply the equity method to an investment that subsequently qualifies for such accounting as a result of an increase in the level of ownership interest or degree of influence. Entities are therefore required to apply the guidance prospectively to increases in the level of ownership interest or degree of influence occurring after the ASU’s effective date. The ASU further requires that unrealized holding gains or losses in accumulated other comprehensive income related to an available-for-sale security that becomes eligible for the equity method be recognized in earnings as of the date on which the investment qualifies for the equity method. The adoption of this guidance did not have any impact our consolidated financial statements.

Recently Issued Accounting Pronouncements Not Yet Adopted

Note 2 - "Significant Accounting Policies" to the consolidated financial statements contained in our Annual Report on Form 10-K for the year ended December 31, 2016 describes accounting pronouncements that were not adopted as of December 31, 2016. Those pronouncements are not yet adopted unless discussed above in "New Accounting Standards Adopted in 2017". In addition, the following pronouncements were issued during the six months ended June 30, 2017 and are not yet adopted.

ASU 2017-09, Stock Compensation - Scope of Modification Accounting

In May 2017, the FASB issued ASU 2017-09, which amends the scope of modification accounting for share-based payment arrangements. The ASU provides guidance on the types of changes to the terms or conditions of share-based payment awards to which an entity would be required to apply modification accounting under Accounting Standards Codification (“ASC”) 718. Specifically, an entity would not apply modification accounting if the fair value, vesting conditions, and classification of the awards are the same immediately before and after the modification. The ASU’s amendments are effective for interim and annual reporting periods beginning after December 15, 2017, although early adoption is permitted. The adoption of this guidance is not expected to have a material impact on our consolidated financial statements.

ASU 2017-07, Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost

In March 2017, the FASB issued ASU 2017-07, which amends the requirements in ASC 715 related to the income statement presentation of the components of net periodic benefit cost for an entity’s sponsored defined benefit pension and other postretirement plans. The ASU requires entities to (1) disaggregate the current-service-cost component from the other components of net benefit cost (the “other components”) and present it with other current compensation costs for related employees in the statement of earnings, and (2) present the other components elsewhere in the statement of earnings and outside of income from operations if such a subtotal is presented. The ASU also requires entities to disclose the captions within the statement of earnings that contain the other components if they are not presented on appropriately described separate lines. In addition, only the service-cost component of the net benefit cost is eligible for capitalization, which is a change from current practice, under which entities capitalize the aggregate net benefit cost when applicable. The ASU’s amendments are effective for interim and annual reporting periods beginning after December 15, 2017, although early adoption is permitted. The adoption of this guidance is not expected to have a material impact on our consolidated financial statements.

ASU 2017-05, Clarifying the Scope of Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets

In February 2017, the FASB issued ASU 2017-05 to clarify the scope of the Board’s guidance on nonfinancial asset derecognition (ASC 610-20) as well as the accounting for partial sales of nonfinancial assets. The ASU conforms the derecognition on nonfinancial assets with the model for transactions in the new revenue standard (ASC 606, as amended). The ASU clarifies that ASC 610-20 applies to the derecognition of all nonfinancial assets and in-substance nonfinancial assets. The ASU also requires an entity to derecognize the nonfinancial asset or in-substance nonfinancial asset in a partial sale transaction when (1) the entity ceases to have a controlling financial interest in a subsidiary pursuant to ASC 810, and (2) control of the asset is transferred in accordance with ASC 606. The ASU is effective for interim and annual reporting periods beginning after December 15, 2017. We expect to adopt this guidance on January 1, 2018 using the modified retrospective approach. We do not expect this adoption to have a material impact on our consolidated financial statements.

2. SIGNIFICANT NEW BUSINESS

RSA

On February 7, 2017, we entered into an agreement to reinsure U.K. employers' liability legacy business of RSA Insurance Group PLC ("RSA"). Pursuant to the transaction, our subsidiary assumed gross insurance reserves of £1,046.4 million ($1,301.8 million), relating to 2005 and prior year business. Net insurance reserves assumed were £927.5 million ($1,153.9 million) and the reinsurance premium paid to Enstar’s subsidiary was £801.6 million ($997.2 million). We elected the fair value option for this reinsurance contract. The initial fair value adjustment on the gross reserves was $174.1 million, and on the net reserves was $156.7 million. Refer to Note 6 - "Fair Value Measurements" for a description of the fair value process and assumptions.

Following the initial reinsurance transaction, which transferred the economics of the portfolio up to the policy's limits, we and RSA are pursuing a portfolio transfer of the business under Part VII of the Financial Services and Markets Act 2000, which would provide legal finality for RSA's obligations. The transfer is subject to court, regulatory and other approvals.

QBE

On January 11, 2017, we closed a transaction to reinsure multi-line property and casualty business of QBE Insurance Group Limited ("QBE"). Our subsidiary assumed gross reinsurance reserves of approximately $1,019.0 million (net

reserves of $447.0 million) relating to the portfolio, which primarily includes workers' compensation, construction defect, and general liability discontinued lines of business. We elected the fair value option for this reinsurance contract. The initial fair value adjustment on the gross reserves was $180.0 million, and on the net reserves was $43.2 million. Refer to Note 6 - "Fair Value Measurements" for a description of the fair value process and assumptions.
In addition our subsidiary has pledged a portion of the premium as collateral to a subsidiary of QBE, and we have provided additional collateral and a limited parental guarantee.

## 3. HELD-FOR-SALE BUSINESSES

On May 12, 2017, we entered into a definitive agreement to sell Laguna Life DAC ("Laguna") for total consideration of €25.6 million (approximately $29.2 million) to a subsidiary of Monument Re Limited. The transaction is expected to close in the third quarter of 2017. The closing of the transaction is subject to customary closing conditions, including regulatory approvals. The proceeds of the sale are expected to be used for general corporate purposes.

On February 17, 2017, we entered into a definitive agreement to sell Pavonia Holdings (US) Inc. and its subsidiaries ("Pavonia") for total consideration of $120.0 million to Southland National Holdings, Inc. The transaction is expected to close in the third or fourth quarter of 2017. The closing of the transaction is subject to customary closing conditions, including regulatory approvals. The proceeds of the sale are expected to be used to pay down our revolving credit facility following closing.

Pavonia and Laguna comprise a substantial portion of the Life and Annuities segment. We have classified the assets and liabilities of the businesses to be sold as held-for-sale. Laguna was classified as held-for-sale as at June 30, 2017 with the prior balance sheet not being reclassified as Laguna did not qualify as a discontinued operation. The following table summarizes the components of assets and liabilities held-for-sale on our consolidated balance sheet as at June 30, 2017 and December 31, 2016 for Pavonia and as at June 30, 2017 for Laguna:

| | June 30, 2017 | | | December 31, 2016 |
|---|---|---|---|---|
| | Pavonia | Laguna | Total | Pavonia |
| Assets: | | | | |
| Short-term investments, trading, at fair value | $— | $4,153 | $4,153 | $— |
| Fixed maturities, trading, at fair value | 298,574 | 35,380 | 333,954 | 326,382 |
| Fixed maturities, held-to-maturity, at amortized cost | 755,381 | — | 755,381 | 765,554 |
| Equities, trading, at fair value | 4,833 | — | 4,833 | 4,428 |
| Other investments, at fair value | 15,385 | — | 15,385 | 15,114 |
| Cash and cash equivalents | 17,322 | 6,319 | 23,641 | 18,018 |
| Restricted cash and cash equivalents | 34,682 | — | 34,682 | 5,202 |
| Deferred tax assets | 31,500 | — | 31,500 | 31,500 |
| Reinsurance balances recoverable | 17,650 | 55 | 17,705 | 18,029 |
| Other assets | 50,406 | 725 | 51,131 | 60,229 |
| Assets of businesses held for sale | 1,225,733 | 46,632 | 1,272,365 | 1,244,456 |
| Less: Accrual of loss on sale | — | (9,609) | (9,609) | — |
| Total assets held for sale | $1,225,733 | $37,023 | $1,262,756 | $1,244,456 |
| | | | | |
| Liabilities: | | | | |
| Policy benefits for life and annuity contracts | $1,129,888 | $6,639 | $1,136,527 | $1,144,850 |
| Other liabilities | 4,867 | 1,166 | 6,033 | 5,937 |
| Total liabilities held for sale | $1,134,755 | $7,805 | $1,142,560 | $1,150,787 |

As of June 30, 2017 and December 31, 2016, included in the table above were restricted investments of $768.1 million and $786.0 million, respectively.

The cumulative currency translation adjustments ("CTA") balance in accumulated other comprehensive income (loss) ("AOCI"), a component of shareholders' equity, included $(13.5) million and $(14.8) million as at June 30, 2017 and December 31, 2016, respectively, related to Pavonia. Upon completion of the sale, the CTA will be included in earnings as a reduction of the gain on sale.

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The Pavonia business qualifies as a discontinued operation. The following table summarizes the components of net earnings (losses) from discontinued operations on the consolidated statements of earnings for the three and six months ended June 30, 2017 and 2016:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2017 | 2016 | 2017 | 2016 |
| INCOME | | | | |
| Net premiums earned | $13,605 | $18,219 | $27,930 | $34,741 |
| Net investment income | 10,277 | 9,088 | 20,306 | 18,697 |
| Net realized and unrealized gains | 1,154 | 3,484 | 2,776 | 3,171 |
| Other income | 395 | 759 | 755 | 762 |
| | 25,431 | 31,550 | 51,767 | 57,371 |
| EXPENSES | | | | |
| Life and annuity policy benefits | 24,112 | 21,391 | 44,782 | 42,213 |
| Acquisition costs | 2,280 | 2,642 | 4,316 | 4,878 |
| General and administrative expenses | 3,718 | 4,713 | 6,775 | 7,128 |
| Other expenses | — | 3 | (16) | 6 |
| | 30,110 | 28,749 | 55,857 | 54,225 |
| EARNINGS (LOSSES) BEFORE INCOME TAXES | (4,679) | 2,801 | (4,090) | 3,146 |
| INCOME TAXES | (192) | (423) | (410) | (563) |
| NET EARNINGS (LOSSES) FROM DISCONTINUED OPERATIONS | $(4,871) | $2,378 | $(4,500) | $2,583 |

The net losses relating to Laguna for the three and six months ended June 30, 2017 were $0.9 million and $1.1 million, respectively. The net earnings relating to Laguna for the three and six months ended June 30, 2016 were $0.4 million and $0.5 million, respectively. These amounts were not significant to our consolidated operations and therefore we have not classified Laguna as a discontinued operation for current or prior periods. As at June 30, 2017 we have recorded a loss on the sale of Laguna of $9.6 million, which has been included in earnings from continuing operations before income taxes in our consolidated statement of earnings. The CTA balance for Laguna was a loss of $8.3 million as at June 30, 2017. Upon completion of the sale of Laguna, the CTA will be reclassified out of AOCI and included in earnings as a component of the loss on sale of Laguna.

The following table presents the cash flows of Pavonia for the six months ended June 30, 2017, and 2016:

| | Six Months Ended June 30, | |
|---|---|---|
| | 2017 | 2016 |
| Operating activities | $23,540 | $(32,295) |
| Investing activities | 5,244 | 40,495 |
| Change in cash and cash equivalents | $28,784 | $8,200 |

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4. INVESTMENTS

We hold: (i) trading portfolios of fixed maturity investments, short-term investments and equities, carried at fair value; (ii) available-for-sale portfolios of fixed maturity and short-term investments carried at fair value; and (iii) other investments carried at either fair value or cost.

Trading

The fair values of our fixed maturity investments, short-term investments and equities classified as trading were as follows:

| | June 30, 2017 | December 31, 2016 |
|---|---|---|
| U.S. government and agency | $692,454 | $ 840,274 |
| Non-U.S. government | 832,839 | 267,363 |
| Corporate | 3,139,580 | 2,387,322 |
| Municipal | 88,722 | 47,181 |
| Residential mortgage-backed | 365,179 | 373,528 |
| Commercial mortgage-backed | 303,087 | 217,212 |
| Asset-backed | 549,832 | 478,280 |
| Total fixed maturity and short-term investments | 5,971,693 | 4,611,160 |
| Equities — U.S. | 106,240 | 95,047 |
| | $6,077,933 | $ 4,706,207 |

Included within residential and commercial mortgage-backed securities as at June 30, 2017 were securities issued by U.S. governmental agencies with a fair value of $248.3 million (as at December 31, 2016: $362.9 million). Included within corporate securities as at June 30, 2017 were senior secured loans of $57.0 million (as at December 31, 2016: $90.7 million).

The contractual maturities of our fixed maturity and short-term investments classified as trading are shown below. Actual maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

| As at June 30, 2017 | Amortized Cost | Fair Value | % of Total Fair Value | |
|---|---|---|---|---|
| One year or less | $838,980 | $840,532 | 14.1 | % |
| More than one year through two years | 632,842 | 636,638 | 10.6 | % |
| More than two years through five years | 1,315,420 | 1,323,779 | 22.2 | % |
| More than five years through ten years | 1,121,737 | 1,139,373 | 19.1 | % |
| More than ten years | 781,744 | 813,273 | 13.6 | % |
| Residential mortgage-backed | 365,226 | 365,179 | 6.1 | % |
| Commercial mortgage-backed | 305,330 | 303,087 | 5.1 | % |
| Asset-backed | 541,584 | 549,832 | 9.2 | % |
| | $5,902,863 | $5,971,693 | 100.0 | % |

Available-for-sale

The amortized cost and fair values of our fixed maturity and short-term investments classified as available-for-sale were as follows:

| As at June 30, 2017 | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses Non-OTTI | Fair Value |
|---|---|---|---|---|
| U.S. government and agency | $ 4,208 | $ — | $ (19 ) | $ 4,189 |
| Non-U.S. government | 82,458 | 894 | (1,057 ) | 82,295 |
| Corporate | 132,314 | 1,632 | (1,445 ) | 132,501 |
| Municipal | 5,944 | 14 | (11 ) | 5,947 |
| Residential mortgage-backed | 41 | — | — | 41 |
| Asset-backed | 3,797 | 1 | — | 3,798 |
| | $ 228,762 | $ 2,541 | $ (2,532 ) | $ 228,771 |

| As at December 31, 2016 | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses Non-OTTI | Fair Value |
|---|---|---|---|---|
| U.S. government and agency | $ 12,784 | $ 32 | $ (106 ) | $ 12,710 |
| Non-U.S. government | 86,897 | 1,303 | (2,777 ) | 85,423 |
| Corporate | 159,243 | 2,040 | (2,628 ) | 158,655 |
| Municipal | 6,585 | 12 | (21 ) | 6,576 |
| Residential mortgage-backed | 488 | 39 | — | 527 |
| Asset-backed | 3,867 | 9 | — | 3,876 |
| | $ 269,864 | $ 3,435 | $ (5,532 ) | $ 267,767 |

The contractual maturities of our fixed maturity and short-term investments classified as available-for-sale are shown below. Actual maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

| As at June 30, 2017 | Amortized Cost | Fair Value | % of Total Fair Value |
|---|---|---|---|
| One year or less | $ 60,862 | $ 60,383 | 26.4 % |
| More than one year through two years | 30,313 | 29,616 | 12.9 % |
| More than two years through five years | 54,675 | 54,677 | 23.9 % |
| More than five years through ten years | 42,760 | 43,669 | 19.1 % |
| More than ten years | 36,314 | 36,587 | 16.0 % |
| Residential mortgage-backed | 41 | 41 | — % |
| Asset-backed | 3,797 | 3,798 | 1.7 % |
| | $ 228,762 | $ 228,771 | 100.0 % |

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Gross Unrealized Losses
The following tables summarize our fixed maturity and short-term investments in a gross unrealized loss position:

| | 12 Months or Greater | | Less Than 12 Months | | Total | |
|---|---|---|---|---|---|---|
| As at June 30, 2017 | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses |
| Fixed maturity and short-term investments, at fair value | | | | | | |
| U.S. government and agency | $— | $ — | $4,190 | $ (19 ) | $4,190 | $ (19 ) |
| Non-U.S. government | 6,330 | (727 ) | 24,596 | (330 ) | 30,926 | (1,057 ) |
| Corporate | 7,856 | (1,168 ) | 36,979 | (277 ) | 44,835 | (1,445 ) |
| Municipal | — | — | 2,711 | (11 ) | 2,711 | (11 ) |
| Total fixed maturity and short-term investments | $14,186 | $ (1,895 ) | $68,476 | $ (637 ) | $82,662 | $ (2,532 ) |

| | 12 Months or Greater | | Less Than 12 Months | | Total | |
|---|---|---|---|---|---|---|
| As at December 31, 2016 | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses |
| Fixed maturity and short-term investments, at fair value | | | | | | |
| U.S. government and agency | $— | $ — | $10,743 | $ (106 ) | $10,743 | $ (106 ) |
| Non-U.S. government | 8,316 | (1,794 ) | 30,086 | (983 ) | 38,402 | (2,777 ) |
| Corporate | 8,003 | (1,800 ) | 42,304 | (828 ) | 50,307 | (2,628 ) |
| Municipal | — | — | 3,132 | (21 ) | 3,132 | (21 ) |
| Total fixed maturity and short-term investments | $16,319 | $ (3,594 ) | $86,265 | $ (1,938 ) | $102,584 | $ (5,532 ) |

As at June 30, 2017 and December 31, 2016, the number of securities classified as available-for-sale in an unrealized loss position was 105 and 156, respectively. Of these securities, the number of securities that had been in an unrealized loss position for twelve months or longer was 35 and 41, respectively.

Other-Than-Temporary Impairment

For the six months ended June 30, 2017 and 2016, we did not recognize any other-than-temporary impairment losses on our available-for-sale securities. We determined that no credit losses existed as at June 30, 2017 and 2016. A description of our other-than-temporary impairment process is included in Note 2 to the consolidated financial statements contained in our Annual Report on Form 10-K for the year ended December 31, 2016. There were no changes to our process during the six months ended June 30, 2017.

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Credit Ratings

The following table sets forth the credit ratings of our fixed maturity and short-term investments as of June 30, 2017:

| | Amortized Cost | Fair Value | % of Total Investments | AAA Rated | AA Rated | A Rated | BBB Rated | Non-Investment Grade | N |
|---|---|---|---|---|---|---|---|---|---|
| Fixed maturity and short-term investments, at fair value | | | | | | | | | |
| U.S. government and agency | $696,264 | $696,643 | 11.2 % | $694,993 | $1,650 | $— | $— | $— | $ |
| Non-U.S. government | 889,325 | 915,134 | 14.8 % | 103,509 | 721,105 | 68,785 | 20,825 | — | 9 |
| Corporate | 3,236,766 | 3,272,081 | 52.8 % | 181,948 | 430,591 | 1,628,525 | 916,671 | 113,010 | 1 |
| Municipal | 93,292 | 94,669 | 1.5 % | 27,067 | 52,969 | 13,175 | 1,458 | — | – |
| Residential mortgage-backed | 365,267 | 365,220 | 5.9 % | 257,904 | 20,365 | 6,948 | — | 78,503 | 1 |
| Commercial mortgage-backed | 305,330 | 303,087 | 4.9 % | 103,087 | 42,854 | 83,588 | 54,538 | 3,323 | 1. |
| Asset-backed | 545,381 | 553,630 | 8.9 % | 274,401 | 51,935 | 87,377 | 55,302 | 82,602 | 2 |
| Total | $6,131,625 | $6,200,464 | 100.0% | $1,642,909 | $1,321,469 | $1,888,398 | $1,048,794 | $277,438 | $ |
| % of total fair value | | | | 26.5 % | 21.3 % | 30.5 % | 16.9 % | 4.5 % | 0 |

Other Investments, at fair value

The following table summarizes our other investments carried at fair value:

| | June 30, 2017 | December 31, 2016 |
|---|---|---|
| Private equities and private equity funds | $269,016 | $ 300,529 |
| Fixed income funds | 249,573 | 249,023 |
| Fixed income hedge funds | 70,900 | 85,976 |
| Equity funds | 230,720 | 223,571 |
| CLO equities | 56,805 | 61,565 |
| CLO equity funds | 13,050 | 15,440 |
| Other | 879 | 943 |
| | $890,943 | $ 937,047 |

The valuation of our other investments is described in Note 6 - "Fair Value Measurements." Due to a lag in the valuations of certain funds reported by the managers, we may record changes in valuation with up to a three-month lag. We regularly review and discuss fund performance with the fund managers to corroborate the reasonableness of the reported net asset values and to assess whether any events have occurred within the lag period that would affect the valuation of the investments. The following is a description of the nature of each of these investment categories:

- Private equities and private equity funds invest primarily in the financial services industry. All of our investments in private equities and private equity funds are subject to restrictions on redemptions and sales that are determined by the governing documents and limit our ability to liquidate those investments. These restrictions have been in place since the dates of our initial investments.

- Fixed income funds comprise a number of positions in diversified fixed income funds that are managed by third-party managers. Underlying investments vary from high-grade corporate bonds to non-investment grade senior secured loans and bonds, but are generally invested in liquid fixed income markets. These funds have regularly published prices. The funds have liquidity terms that vary from daily up to quarterly.
- Fixed income hedge funds invest in a diversified portfolio of debt securities. The hedge funds have imposed lock-up periods of up to three years from the time of initial investment. Once eligible, redemptions are permitted quarterly with 90 days' notice.

- Equity funds invest in a diversified portfolio of international publicly traded equity securities. The funds have liquidity terms that vary from daily to every two weeks.
- CLO equities comprise investments in the equity tranches of term-financed securitizations of diversified pools of corporate bank loans. CLO equities denote direct investments by us in these securities.
- CLO equity funds comprise two funds that invest primarily in the equity tranches of term-financed securitizations of diversified pools of corporate bank loans. One of the funds has a fair value of $1.4 million, part of a self-liquidating structure that is expected to pay out over one to five years. The other fund has a fair value of $11.6 million and is eligible for redemption in 2018.
- Other primarily comprises a fund that provides loans to educational institutions throughout the United States and its territories.

Investments of $0.4 million in fixed income hedge funds were subject to gates or side-pockets, where redemptions are subject to the sale of underlying investments. A gate is the ability to deny or delay a redemption request, whereas a side-pocket is a designated account for which the investor loses its redemption rights.

As at June 30, 2017, we had unfunded commitments to private equity funds of $183.7 million.

Other Investments, at cost

Our other investments carried at cost of $128.3 million as of June 30, 2017 consist of life settlement contracts. During the six months ended June 30, 2017 and 2016, net investment income included $9.3 million and $10.0 million, respectively, related to investments in life settlements. There were impairment charges of $6.3 million and $2.9 million recognized in net realized and unrealized gains/losses during the six months ended June 30, 2017 and 2016, respectively, related to investments in life settlements. The following table presents further information regarding our investments in life settlements as of June 30, 2017 and December 31, 2016.

| | June 30, 2017 | | | December 31, 2016 | | |
|---|---|---|---|---|---|---|
| | Number of Contracts | Carrying Value | Face Value (Death Benefits) | Number of Contracts | Carrying Value | Face Value (Death Benefits) |
| Remaining Life Expectancy of Insureds: | | | | | | |
| 0 – 1 year | 2 | $467 | $700 | 2 | $461 | $700 |
| 1 – 2 years | 8 | 12,025 | 20,075 | 7 | 11,396 | 18,337 |
| 2 – 3 years | 11 | 17,655 | 36,718 | 11 | 15,338 | 29,715 |
| 3 – 4 years | 17 | 13,369 | 24,507 | 17 | 17,013 | 32,189 |
| 4 – 5 years | 10 | 12,778 | 29,110 | 16 | 10,377 | 23,302 |
| Thereafter | 173 | 72,002 | 409,239 | 181 | 77,066 | 431,034 |
| Total | 221 | $128,296 | $520,349 | 234 | $131,651 | $535,277 |

Remaining life expectancy for year 0-1 in the table above references policies whose current life expectancy is less than 12 months as of the reporting date. Remaining life expectancy is not an indication of expected maturity. Actual maturity in any category above may vary significantly (either earlier or later) from the remaining life expectancies reported.

At June 30, 2017, our best estimate of the life insurance premiums required to keep the policies in force, payable in the 12 months ending June 30, 2018 and the four succeeding years ending June 30, 2022 is $17.9 million, $17.8 million, $17.7 million, $16.3 million and $15.7 million, respectively.

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Net Realized and Unrealized Gains
Components of net realized and unrealized gains for the three and six months ended June 30, 2017 and 2016 were as follows:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2017 | 2016 | 2017 | 2016 |
| Net realized gains (losses) on sale: | | | | |
| Gross realized gains on fixed maturity securities, available-for-sale | $177 | $114 | $337 | $379 |
| Gross realized losses on fixed maturity securities, available-for-sale | (75) | (1) | (86) | (244) |
| Net realized gains (losses) on fixed maturity securities, trading | 65 | 1,490 | (987) | (416) |
| Net realized gains on equity securities, trading | 236 | 555 | 810 | 1,028 |
| Net realized investment losses on funds held - directly managed | (289) | — | (4,142) | — |
| Total net realized gains (losses) on sale | $114 | $2,158 | $(4,068) | $747 |
| Net unrealized gains: | | | | |
| Fixed maturity securities, trading | $11,226 | $37,871 | $34,542 | $81,067 |
| Equity securities, trading | 1,871 | 405 | | |