

CASTLEPOINT NATIONAL INSURANCE COMPANY, in liquidation

Selected Financial Information and Analysis

As of and for the year ended December 31, 2017 and for the period from April 1, 2017 (effective date of liquidation) to December 31, 2017

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Overview

CastlePoint National Insurance Company (CNIC or the Company) is the surviving entity from a merger with Tower Insurance Company of New York, CastlePoint Insurance Company, Hermitage Insurance Company, Massachusetts Homeland Insurance Company, North East Insurance Company, Preserver Insurance Company, Tower National Insurance Company, York Insurance Company of Maine and CastlePoint Florida Insurance Company (pre-merger affiliates). The merger agreement was structured so that CNIC will have responsibility for all of Tower's direct insurance business. CNIC and the pre-merger affiliates (except for CastlePoint Florida Insurance Company) were members of Tower's US Pool. Subsequent to the completion of the merger, on July 28, 2016, CNIC was placed into conservation by the Superior Court of the State of California and subject to the oversight of the California Insurance Commissioner. The Company is owned by Tower Group, Inc., which in turn is owned by Tower Group International Ltd. (Tower). Tower was acquired by ACP Re, Ltd. (ACPRe) on September 15, 2014 and was contributed to a special purpose trust formed in Bermuda in September 2016 as more fully described below.

Pursuant to the July 28, 2016 Order Appointing Insurance Commissioner as Conservator and Restraining Orders (the Conservation Order), the California Insurance Commissioner was appointed as the statutory Conservator of the Company. The Commissioner also filed a Conservation and Liquidation Plan for the Company which was approved September 13, 2016. As part of the Conservation and Liquidation Plan, ACP Re commuted its aggregate stop loss reinsurance retrocession agreement with two affiliated companies who in turn provided aggregate stop loss reinsurance protection to CastlePoint Reinsurance Company (CPRe), (a Bermuda reinsurance company that was an affiliate of CNIC) and those companies' aggregate stop loss to CPRe were also cancelled, terminated and commuted. Concurrent with the execution of these agreements, CPRe commuted all of its reinsurance agreements with CNIC and the pre-merged companies, with consideration to CNIC being all of net tangible assets of CPRe, such that after the commutation CPRe has no further obligation to CNIC. Finally, CNIC received a cash payment of \$200 million from the owners of ACPRe in exchange for their agreement to the commutation agreements. CNIC used these funds to pay losses and other expenses of the estate while in conservation. Finally, pursuant to the Conservation and Liquidation Plan, ACP Re transferred its ownership interest in the stock of all of the remaining Tower companies to a purpose trust formed in Bermuda and as of September 2016 has no control over CNIC or ownership of any other of the Tower companies.

In accordance with the Conservation and Liquidation Plan, two Administrative Services Agreements were executed with AmTrust Financial Services Inc. and with National General Holdings Company for the continuity of claims servicing and payment processing for a period of 24 months.

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On March 30, 2017, the Superior Court of the State of California issued a Liquidation Order (the Order), effective April 1, 2017, for the Company. The Order directs the Liquidator to liquidate and wind up the business of CastlePoint and to act in all ways and exercise all powers necessary for the purpose of carrying out this Order and the Liquidation provision of the California Insurance Co, Insurance Sections 1010 et seq. On April 1, 2017 all direct claims of CastlePoint (and the merged entities) that arose under policies of insurance that are protected by State Guaranty Funds were transferred to the State Guaranty Funds that have jurisdiction over the claims. All claims issued under direct policies of insurance that are not protected by State Guaranty Funds were transferred back to the insureds under the policies, and such insureds are eligible to file a proof of claim with the Liquidator. Such proofs of claim forms were mailed to insureds and all other potential creditors in the second quarter of 2017, with a final claims bar date of December 31, 2017. Proofs of claim filed by those direct insureds without Guaranty Fund protection and approved by the Liquidator will receive the same creditor classification as those claims filed by the State Guaranty Funds.

Other creditors, including claims that arose from policies of reinsurance issued by the Company are subordinated to the claims of the Guaranty Funds and the direct claims of insureds not protected by Guaranty Funds.

The accompanying balance sheets are presented as of March 31, 2017 (which was the date that the Company was moved from conservation to liquidation) and December 31, 2017. The statement of operations and statement of cash flows are presented for the year ended December 31, 2017, as well as for the nine month period ended December 31, 2017 (such period representing the time that the Company has been in liquidation).

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Statutory Balance Sheets
(Unaudited)

(\$ in thousands)	31-Dec-17	31-Mar-17	Increase (Decrease)
Admitted Assets			
Cash and invested assets			
Unrestricted assets	\$ 143,181	\$ 75,878	\$ 67,303
Restricted assets			
Pledged to states	97,747	320,689	(222,942)
Pledged for reinsurance	78,052	80,625	(2,573)
Funds at Lloyds and other invested assets	1,538	42,072	(40,534)
Total restricted assets	177,337	443,386	(266,049)
Total cash and invested assets	320,518	519,264	(198,746)
Investment income due and accrued	2,108	3,589	(1,481)
Uncollected premiums and agents' balances	-	834	(834)
Amounts recoverable from reinsurers	4,450	26,503	(22,053)
Funds held by or deposited with reinsured companies	772	772	-
Advances to CA Insurance Guarantee Association	227,576	-	227,576
Miscellaneous assets	32,717	52,533	(19,816)
Total admitted assets	\$ 588,141	\$ 603,495	\$ (15,354)
Liabilities, capital and surplus			
Liabilities			
Reserve for losses and loss adjustment expenses	\$ 814,653	\$ 829,659	\$ (15,006)
Reinsurance payable on paid losses and LAE	9,131	10,561	(1,430)
Ceded reinsurance premiums payable	(358)	1,490	(1,848)
Funds held by company under reinsurance treaties	18,434	21,832	(3,398)
Payable to Guaranty Funds	6,112	-	6,112
Miscellaneous liabilities	24,069	21,313	2,756
Total liabilities	872,041	884,855	(12,814)
Capital and surplus			
Common capital stock	4,200	4,200	-
Surplus notes	3,000	3,000	-
Gross paid in and contributed surplus	521,742	521,742	-
Unassigned deficit	(813,153)	(810,613)	(2,540)
Special surplus funds from retroactive reinsurance	311	311	-
Total capital and surplus	(283,900)	(281,360)	(2,540)
Total liabilities, capital and surplus	\$ 588,141	\$ 603,495	\$ (15,354)

CASTLEPOINT NATIONAL INSURANCE COMPANY, in liquidation

Selected Financial Information and Analysis

Notes to Statutory Balance Sheets

Assets

Total cash and invested assets were \$320.5 million at December 31, 2017 compared to \$519.3 million at March 31, 2017. As the Company was ordered into liquidation effective April 1, 2017, all investment amounts are carried at market, which the Company believes represents realizable value. The decrease is primarily due to a transfer of securities and cash to certain insurance guarantee associations for future claim payments. Transfers of \$226.7 million and \$0.9 million were made to the California Insurance Guarantee Association and the Idaho Insurance Guarantee Association respectively.

Investment income due and accrued decreased by \$1.5 million, to \$2.1 million at December 31, 2017 compared to \$3.6 million at March 31, 2017, primarily due to a lower amount of investments held at year end.

Reinsurance recoverable was \$4.5 million at December 31, 2017 compared to \$26.5 million at March 31, 2017. Balances collected during the second quarter to fourth quarter 2017 were \$22.0 million, compared to collections of \$18.3 million in the first quarter 2017. None of these balances are currently in dispute. Reinsurance contracts do not relieve CNIC from its obligations to policyholders. Failure of reinsurers to honor their obligations could result in losses to CNIC.

Funds held by or deposited with reinsured companies were \$0.8 million at December 31, 2017 and March 31, 2017.

CASTLEPOINT NATIONAL INSURANCE COMPANY, in liquidation

Selected Financial Information and Analysis

Notes to Statutory Balance Sheets, continued

Assets, continued

Miscellaneous Assets (Unaudited)

(\$ in thousands)	31-Dec-17	31-Mar-17	Increase (Decrease)
Tangible value of CPRe due to Estate	\$ 8,400	\$ 10,888	\$ (2,488)
Loss payment suspense	3,366	6,719	(3,353)
Involuntary fair plan assumed	9,719	9,719	-
Workers' compensation fund assessment	5,741	6,589	(848)
Receivable from residual market pools	3,209	3,209	-
Advances to TPA's	(50)	9,472	(9,522)
Receivable from AmTrust	-	(222)	222
Other	2,332	6,159	(3,827)
Total	\$ 32,717	\$ 52,533	\$ (19,816)

Miscellaneous assets were \$32.7 million at December 31, 2017 compared to \$52.5 million at March 31, 2017. The amounts receivable from CPRe represent CPRe's net tangible assets due to CNIC under the terms of the commutation agreement with CPRe. The receivable from CPRe was reduced at year-end 2017 to \$8.4 million, which represents the best estimate of the current realizable value of the receivable in 2018. CNIC is currently negotiating the sale of this receivable with an interested third party buyer, and if such transaction is completed, expects to receive the carrying value in cash before the end of the second quarter 2018. As of March 31, 2017, TPA's are no longer handling Tower's losses and returned \$9.5 million during the first nine months of liquidation that had been advanced by CNIC to pay claims. Other amounts at December 31, 2017 represent funds held for the benefit of CNIC by State National Insurance Company under an old reinsurance agreement.

Liabilities

The Company's net loss and LAE reserves were \$814.7 million at December 31, 2017 compared to \$829.7 million at March 31, 2017. The balance as of December 31, 2017 represents the net reserves transferred to the State Guaranty Funds for all claims valued as of March 31, 2017 the date the Company went into liquidation, reduced by payment data reported by the insurance guarantee associations and payments made by the Liquidator, primarily for LAE and for certain workers' comp indemnity benefits. The Company received second quarter data from certain of the guarantee funds in August and September 2017. The Company expects to receive information from all of the guarantee associations for the balance of 2017 activity in the first and second quarters of 2018, and will update its reserve position upon the receipt of such data.

Reinsurance payable on paid losses and LAE were \$9.1 million at December 31, 2017 compared to \$10.6 million at March 31, 2017. Under the Conservation and Liquidation Plan, the Company is no longer making payments on assumed business and is only permitting its cedants to draw down any available collateral against their balances.

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Selected Financial Information and Analysis

Notes to Statutory Balance Sheets, continued

Liabilities, continued

Ceded reinsurance premiums payable were (\$0.3) million at December 31, 2017 compared to \$1.5 million at March 31, 2017. The balance decreased by \$1.8 million between March 2017 and December 2017.

Funds held by the Company were \$18.4 million at December 31, 2017 compared to \$21.8 million at March 31, 2017. The decrease of \$3.4 million is primarily due to losses paid on a quota share treaty.

The Company had no balances payable to parent and affiliates at December 31, 2017 and March 31, 2017.

Payable to Guaranty funds of \$6.1 million at December 31, 2017 represents claim payments made by affected state insurance guaranty associations to claimants under policies issued by CastlePoint.

Miscellaneous liabilities were \$24.1 million at December 31, 2017 compared to \$21.3 million at March 31, 2017. Included in this balance are outstanding checks of \$16.9 million at December 31, 2017 and March 31, 2017.

Capital and Surplus Accounts

The following table sets forth the changes in policyholders' surplus for the twelve months and nine months ended December 31, 2017:

Changes in Policyholders' Surplus

(Unaudited)

(\$ in thousands)	Twelve months ended December 31, 2017	Nine months ended December 31, 2017
Policyholders' surplus, beginning period	\$ (281,909)	\$ (281,360)
Net income	1,756	2,288
Change in net unrealized capital gains	(3,802)	(4,353)
Change in non-admitted assets	(391)	(850)
Aggregate write-ins for gains and losses in surplus	446	375
Policyholders' surplus, ending period	\$ (283,900)	\$ (283,900)

Surplus decreased by \$2.0 million as net income was less than the change in unrealized capital losses and the change in non-admitted assets noted below.

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Selected Financial Information and Analysis

Capital and Surplus Accounts, continued

Changes in Non-Admitted Assets

(Unaudited)

(\$ in thousands)	Twelve months ended December 31, 2017	Nine months ended December 31, 2017
Premium receivable	\$ (850)	\$ (850)
Other assets	459	-
Total change in non-admitted assets	\$ (391)	\$ (850)

Since the Company was placed into liquidation, there has been an elimination of the remaining agent balances. In the first quarter of 2017, the Company reversed the TPA advance allowance, as such advances were returned upon transfer of the claims to state guarantee associations.

Statements of Operations

(Unaudited)

(\$ in thousands)	Twelve months ended December 31, 2017	Nine months ended December 31, 2017
Premium earned	\$ (168)	\$ (90)
Losses incurred and loss adjustment expenses incurred	430	-
Other underwriting expenses incurred	6,725	3,441
Net underwriting income (loss)	(7,323)	(3,531)
Net investment income earned	9,022	6,452
Net realized capital gain (loss)	(105)	(416)
Net investment gain (loss)	8,917	6,036
Other income (expenses)	162	(217)
Net income	\$ 1,756	\$ 2,288

Notes to Statements of Operations

Loss and loss adjustment expenses incurred

The Company reported loss and loss adjustment expenses incurred of \$0.4 million for the twelve months ended December 31, 2017, all of which were incurred prior to being placed into liquidation.

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Selected Financial Information and Analysis

Notes to Statements of Operations, continued

Other underwriting expenses

Other underwriting expenses for the twelve months ended December 31, 2017 were \$6.7 million compared to \$3.3 million of which were incurred prior to the Company being placed into liquidation. The table below details charges by components.

	Other Underwriting Expenses	
	(Unaudited)	
	Twelve months ended	Nine months ended
(\$ in thousands)	December 31, 2017	December 31, 2017
Commission and BB&A	\$ 1,403	\$ (327)
Salaries and employee benefits	2,873	1,726
Rent & depreciation	163	128
Professional services	3,951	2,617
Other (income)	(1,665)	(703)
Total	\$ 6,725	\$ 3,441

Since the Company has been in liquidation, no further commissions or BB&T were being incurred. The charge for the full year was primarily associated with \$2.0 million of sliding scale ceded commission for the Company's reinsurance covers recorded during the three months ended March 31, 2017. The decrease in salaries and employee benefits since liquidation were due to the reduction in the employee head count. Miscellaneous income in 2017 was comprised of various state premium tax refunds and returns of assessments which were not accrued when the Company was placed into conservation.

Net investment income and net realized capital gains (losses)

Net investment income earned was \$9.0 million for the twelve months ended December 31, 2017 compared to \$2.6 million for the three months ended March 31, 2017.

Net realized capital loss were \$0.1 million for the twelve months ended December 31, 2017 compared to net capital gains of \$0.3 million for the three months ended March 31, 2017. Capital losses since liquidation include a charge of \$2.9 million to reduce the receivable balance of CPRe to its expected realizable value.

Other expenses

The benefit in other expenses represents primarily recoveries of agent balances that were previously written off.

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Statutory Statements of Cash Flow

(Unaudited)

(\$ in thousands)	Twelve months ended December 31, 2017	Nine months ended December 31, 2017
Cash from Operations		
Benefit and loss related payments	\$ (74,196)	\$ 16,349
Commission and other expenses paid	(19,992)	(4,215)
Premiums collected net of reinsurance	(2,975)	(936)
Net investment income	11,658	7,857
Miscellaneous income (expense)	(281)	(243)
Net cash provided by (used in) operations	(85,786)	18,812
Net cash provided by (used in) investments	(43,117)	(65,497)
Net cash provided by miscellaneous sources	28,263	14,711
Net change in cash and cash equivalents	(100,640)	(31,974)
Cash and cash equivalents Beginning of year	179,444	110,778
Cash and cash equivalents, end of period	\$ 78,804	\$ 78,804

Notes to Statutory Statements of Cash Flows

CNIC used cash of \$100.6 million for the year ended December 31, 2017 and \$68.7 million for the three months ended March 31, 2017. For the year ended December 31, 2017, the Company paid net claims of \$74.2 million, and paid \$23.2 million for other operating activities. The bulk of these claim payments were made in the first quarter, prior to the Company being placed into liquidation. The Company reduced its investments by \$43.1 million (excluding the amounts advanced to certain Guarantee Funds) and received cash from CPRe of \$8.9 million and cash from repayments of advances to TPAs of \$11.1 million. The Company is in liquidation effective April 1, 2017, and as such expects its future cash outflows will be limited to operating expense and to distributions to State Guarantee Associations.

The Cash and cash equivalents of \$78.8 million at December 31, 2017 ties to the amount that would be included in the Company's statutory presentation of assets. A reconciliation to the accompanying balance sheet is presented below (\$000):

Bonds	\$240,176
Cash	78,804
Other Invested assets	<u>1,538</u>
Total	<u>\$320,518</u>