JOHNSON LAMBERT LLP

# Energy Insurance Mutual Limited

## Audited Financial Statements

*Years ended December 31, 2012 and 2011*
with Report of Independent Auditors

# Energy Insurance Mutual Limited

## Audited Financial Statements

Years ended December 31, 2012 and 2011

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JOHNSON LAMBERT LLP

# Report of Independent Auditors

To the Audit Committee of the Board of Directors
Energy Insurance Mutual Limited

**Report on the Financial Statements**

We have audited the accompanying [consolidated] financial statements of Energy Insurance Mutual Limited ("the Company") which comprise the balance sheets as of December 31, 2012 and 2011 and the related statements of comprehensive income, changes in shareholders' equity and cash flows for years then ended and the related notes to the financial statements.

**Management's Responsibility for the Financial Statements**
Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

**Auditor's Responsibility**
Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about 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 auditor's 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 auditor considers 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. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

**Opinion**
In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Energy Insurance Mutual Limited at December 31, 2012 and 2011, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America

Johnson Lambert LLP

Jacksonville, Florida
March 1, 2013

Energy Insurance Mutual Limited

# Balance Sheets

*(Expressed in Thousands of U.S. Dollars)*

| | As of December 31, 2012 | As of December 31, 2011 |
|---|---|---|
| Assets | | |
| Investments, available-for-sale | $ 1,301,621 | $ 1,149,639 |
| Investment in subsidiary | 1,923 | 1,586 |
| Total investments | 1,303,544 | 1,151,225 |
| Cash and cash equivalents | 63,413 | 60,650 |
| Reinsurance recoverable | 399,670 | 375,604 |
| Prepaid reinsurance premiums | 40,702 | 42,492 |
| Accrued investment income | 7,227 | 6,105 |
| Receivable for securities sold | 4,321 | 3,625 |
| Due from subsidiary | 10,364 | 10,987 |
| Premiums receivable | 5,561 | 4,064 |
| Deferred policy acquisition costs | 1,081 | 1,148 |
| Income taxes recoverable | 11,205 | - |
| Other assets | 686 | 824 |
| Total assets | $ 1,847,774 | $ 1,656,724 |
| Liabilities and policyholders' surplus | | |
| Liabilities: | | |
| Reserve for losses and loss adjustment expenses | $ 820,734 | $ 680,650 |
| Unearned premiums | 109,558 | 105,240 |
| Reinsurance premiums payable | 34,975 | 25,713 |
| Payable for securities purchased | 6,202 | 15,186 |
| Accounts payable and accrued expenses | 8,194 | 7,045 |
| Net deferred tax liability | 45,133 | 30,957 |
| Income taxes payable | - | 9,300 |
| Total liabilities | 1,024,796 | 874,091 |
| Policyholders' surplus: | | |
| Accumulated other comprehensive income | 134,848 | 102,681 |
| Members' account balance | 688,130 | 679,952 |
| Total policyholders' surplus | 822,978 | 782,633 |
| Total liabilities and policyholders' surplus | $ 1,847,774 | $ 1,656,724 |

*See accompanying notes to the financial statements*

Energy Insurance Mutual Limited

## Statements of Income and Comprehensive Income

*(Expressed in Thousands of U.S. Dollars)*

| | Years ended December 31, 2012 | 2011 |
|---|---|---|
| Underwriting revenue | | |
| Net premiums earned | | |
| Direct and assumed premiums earned | $ 191,959 | $ 176,804 |
| Ceded premiums earned | (80,651) | (81,149) |
| Net premiums earned | 111,308 | 95,655 |
| Ceding commission income | 2,864 | 2,692 |
| Total underwriting revenue | 114,172 | 98,347 |
| Underwriting expenses | | |
| Net losses and loss adjustment expenses | | |
| Gross and assumed losses and loss adjustment expenses | 215,994 | 118,160 |
| Ceded losses and loss adjustment expenses | (60,229) | (70,290) |
| Net losses and loss adjustment expenses | 155,765 | 47,870 |
| Policy acquisition costs | 2,107 | 1,867 |
| Administrative expenses | 11,292 | 9,734 |
| Total underwriting expenses | 169,164 | 59,471 |
| (Loss) income from underwriting | (54,992) | 38,876 |
| Investment income | | |
| Net realized gain on investments sold | 23,285 | 13,926 |
| Other-than-temporary impairments | (554) | (3,574) |
| Interest and dividends | 35,565 | 36,242 |
| Total investment income | 58,296 | 46,594 |
| Income before policyholders' distribution and income taxes | 3,304 | 85,470 |
| Policyholders' distribution | - | - |
| Income before income taxes | 3,304 | 85,470 |
| Income tax benefit (expense) | | |
| Current income tax benefit (expense) | 1,731 | (23,914) |
| Deferred income tax benefit (expense) | 3,143 | (5,613) |
| Total income tax benefit (expense) | 4,874 | (29,527) |
| Net income | $ 8,178 | $ 55,943 |

(continued)

*See accompanying notes to the financial statements*

# Energy Insurance Mutual Limited

## Statements of Income and Comprehensive Income
*(Expressed in Thousands of U.S. Dollars)*

| | Years ended December 31, | |
|---|---|---|
| | 2012 | 2011 |
| Comprehensive income | | |
| Net income | $ 8,178 | $ 55,943 |
| Net unrealized gains (losses) on available-for-sale securities, net of income taxes of $9,365 and $(3,926), respectively | 17,392 | (7,291) |
| Less: reclassification adjustment for net gains realized in net income, net of income taxes of $7,956 and $3,623, respectively | 14,775 | 6,729 |
| Other comprehensive income (loss), net of tax | 32,167 | (562) |
| Comprehensive income | $ 40,345 | $ 55,381 |

*See accompanying notes to the financial statements*

# Energy Insurance Mutual Limited

## Statement of Changes in Policyholders' Surplus

(*Expressed in Thousands of U.S. Dollars)*

| | Accumulated Other Comprehensive Income | Members' Account Balance | Total |
|---|---|---|---|
| Balance at January 1, 2011 | $ 103,243 | $ 624,009 | $ 727,252 |
| Net unrealized losses arising during the period on securities available-for-sale, net of tax | (562) | - | (562) |
| Net income | - | 55,943 | 55,943 |
| Balance at December 31, 2011 | 102,681 | 679,952 | 782,633 |
| Net unrealized gains arising during the period on securities available-for-sale, net of tax | 32,167 | - | 32,167 |
| Net income | - | 8,178 | 8,178 |
| Balance at December 31, 2012 | $ 134,848 | $ 688,130 | $ 822,978 |

*See accompanying notes to the financial statements*

# Energy Insurance Mutual Limited

## Statements of Cash Flows
*(Expressed in Thousands of U.S. Dollars)*

| | Years ended December 31, 2012 | 2011 |
|---|---|---|
| Net income | $ 8,178 | $ 55,943 |
| Cash flows from operating activities: | | |
| Depreciation | 113 | (217) |
| Amortization of bond premium or discount | 3,854 | 1,803 |
| Net realized investment gain | (22,731) | (10,352) |
| Deferred income taxes | (3,143) | 5,614 |
| Equity in earnings of subsidiary | (337) | (66) |
| Changes in operating assets and liabilities: | | |
| Reinsurance recoverable | (24,066) | 35,664 |
| Prepaid reinsurance premiums | 1,790 | (177) |
| Premiums receivable | (1,497) | (1,413) |
| Other assets | (729) | (719) |
| Reserve for losses and loss adjustment expenses | 140,084 | (120,742) |
| Unearned premiums | 4,318 | 11,187 |
| Reinsurance premiums payable | 9,262 | 9,409 |
| Due from subsidiary | 623 | (6,719) |
| Accounts payable and other accrued expenses | 1,148 | 1,002 |
| Income taxes recoverable | (20,505) | (8,309) |
| Net cash from operations | 96,362 | (28,092) |
| Cash flows from investing activities: | | |
| Cost of investments purchased | (1,302,658) | (2,582,194) |
| Proceeds from sales of investments | 1,189,024 | 2,568,799 |
| Proceeds from maturities of investments | 30,017 | 79,296 |
| Change in payable from purchase of investments | (9,680) | (110,062) |
| Purchases of fixed assets | (302) | - |
| Net cash from investing | (93,599) | (44,161) |
| Cash flows from financing activities: | | |
| Draws on line of credit | 10,500 | 50,000 |
| Repayments on line of credit | (10,500) | (50,000) |
| Net cash from financing | - | - |
| Net change in cash and cash equivalents | 2,763 | (72,253) |
| Cash and cash equivalents, beginning of year | 60,650 | 132,903 |
| Cash and cash equivalents, end of year | $ 63,413 | $ 60,650 |
| Supplemental disclosure of cash flow information: | | |
| Income taxes paid | $ 18,775 | $ 31,803 |

*See accompanying notes to the financial statements*

Energy Insurance Mutual Limited

Notes to Financial Statements

Years ended December 31, 2012 and 2011

**Note A - Organization and Significant Accounting Policies**

*Organization*
Energy Insurance Mutual Limited (the "Company" or "EIM") was incorporated under the Companies Act of Barbados on June 13, 1986. EIM obtained a license to engage in exempt insurance business, in accordance with the provisions of the Exempt Insurance Act of Barbados, 1983. On August 12, 2003, the Company applied for, and was granted a license to operate as a Qualifying Insurance Company under the Insurance Act 1992-2 of Barbados.

The Company is a mutual insurance company with membership available to any utility or member of the energy services industry that meets EIM's underwriting standards. The Company provides excess general liability, excess fiduciary liability and excess directors and officers liability policies written on a claims first made basis. In addition, to a lesser extent the Company writes property insurance for its members. All members have casualty policies in place, approximately one-third of those members have property policies as well.

*Basis of Reporting*
The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP") promulgated by the Financial Accounting Standards Board Accounting Standards Codification ("ASC" or "the guidance"). Preparation of financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the reported amounts 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 could differ from those estimates.

*Investment in Subsidiary*
The Company is the sponsor and 100% common stockholder of Energy Insurance Services, Inc. (“EIS”), a sponsored cell captive insurance company domiciled in South Carolina.

As a sponsored captive, EIS allows EIM members, known as Mutual Business Programs (“MBP”), to insure or reinsure the risks of their sponsoring organizations, including property, general and environmental liability, asbestos, workers’ compensation and retiree medical stop loss. Through Participation Agreements with the MBPs, the insurance risks underwritten by the MBPs are contractually limited to the funds available in the individual cell’s account. Likewise, EIS has no right to the capital and accumulated profits of the MBP cells.

The Company accounts for its investment in EIS using the equity method of accounting because EIM is not the primary beneficiary in accordance with the accounting guidance for Consolidations.

**Note A - Organization and Significant Accounting Policies (Continued)**

As of December 31, 2012, EIS has assets (exclusive of assets held in MBPs) of approximately $10.7 million, shareholder's equity of $1.9 million and net income of approximately $337,000. As of December 31, 2011, EIS had assets (exclusive of assets held in MBPs) of approximately $12.3 million, shareholder's equity of $1.6 million and a net income of approximately $66,000.

The Company and EIS file a consolidated federal income tax return. Income taxes are allocated based on separate return calculations. During 2012 and 2011, EIM provided reinsurance to certain EIS cells. For the years ended December 31, 2012 and 2011, premiums earned included $450,000 of premium assumed from EIS.

*Investments*
Management determines the appropriate classification of fixed-maturity and equity securities at the time of purchase. The Company's policy is to hold securities for investment purposes and, as such, has reported all securities as available-for-sale. Available-for-sale securities are carried at fair value, with the unrealized gains and losses, net of tax, reported in a separate component of policyholders' surplus. Interest and dividends on securities classified as available-for-sale are included in net investment income. Declines in value judged to be other-than-temporary are included as realized losses in the statement of income. The cost of securities sold is based on specific identification.

*Cash and Cash Equivalents*
The Company considers all highly liquid investments with original maturities of three months or less to be cash equivalents. The Company maintains certain cash and cash equivalent balances that are not subject to FDIC insurance. Management does not believe these balances represent a significant credit risk to the Company.

*Losses and Loss Adjustment Expense Reserves*
The reserve for losses and loss adjustment expenses represents the estimated ultimate gross cost of all reported and unreported losses incurred through December 31. Since the Company provides principally high level excess of loss coverage to its members, it is exposed to severe but infrequent claims. Therefore, standard actuarial methods, such as paid loss development, are inappropriate to use. Losses are determined based on projecting average loss and expected number of claims after reviewing historical known losses and claim counts and understanding how exposures to loss have changed over policy periods. Aggregate expected losses are represented by these estimates and theoretical size of loss distribution based upon an actuarial analysis prepared by a consulting actuary.

**Note A - Organization and Significant Accounting Policies (Continued)**

Case reserves represent the estimated future payments on reported losses. Case reserves are continually reviewed and updated; however, given the uncertainty regarding the extent of the Company's ultimate liability, a significant additional liability could develop. Supplemental reserves (e.g., IBNR) are recorded based on actuarial projections. Although considerable variability is inherent in these estimates, particularly due to the limited number of claims to date, management believes that the aggregate reserve for losses and loss adjustment expenses is adequate. These estimates are periodically reviewed and adjusted as necessary as experience develops or new information becomes known. Such adjustments are included in current operations.

*Premiums*
Direct and assumed premiums are recognized as revenue on a pro-rata basis over the policy term. The portion of premiums that will be earned in the future is deferred and reported as unearned premiums. The Company pays commissions on assumed business, which is expensed over the life of the policy.

*Reinsurance*
In the normal course of business, the Company seeks to reduce the loss that may arise from large claims, catastrophes or other events by reinsuring certain levels of risk in various areas of exposure with other insurance companies. Reinsurance premiums, loss reimbursement and reserves related to reinsured claims are accounted for on a basis consistent with that used in accounting for the original policies or claims.

*Deferred Policy Acquisition Costs*
Commissions and other costs of acquiring insurance that vary with and are directly related to the production of new and renewal business are deferred and amortized over the life of the policy to which they relate. These costs are deferred, net of related ceding commissions, to the extent recoverable, and are amortized over the period during which the related premiums are earned.

The Company adopted new accounting guidance related to the deferral of policy acquisition costs during 2012. This guidance modifies the definition by specifying that the costs of acquiring insurance must be directly related to the successful acquisition of new and renewal business. The adoption had no effect on the Company's deferred policy acquisition costs.

*Income Taxes*
Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled.

## Note A - Organization and Significant Accounting Policies (Continued)

*Policyholder Distribution*
As a mutual insurer, EIM is owned by its policyholders. Policyholder distributions are charged to income when declared by the Board of Directors. No policyholder distributions were made for the years ended December 31, 2012 and 2011. On January 8, 2013, the Board of Directors approved the declaration of policyholder distributions in the amount of $18 million.

*Reclassifications*
Certain balances in the 2011 financial statements have been reclassified to conform to the 2012 presentation.

*Subsequent Events*
The Company has evaluated subsequent events for disclosure and recognition through March 1, 2013, the date on which these financial statements were available to be issued.

## Note B - Insurance Activity

Premium activity for 2012 and 2011 is summarized as follows *(in thousands)*:

| | Direct | Assumed | Ceded | Net |
|---|---|---|---|---|
| 2012 | | | | |
| Premiums written | $ 194,314 | $ 1,963 | $ (78,861) | $ 117,416 |
| Change in unearned premiums | (4,057) | (261) | (1,790) | (6,108) |
| Premiums earned | $ 190,257 | $ 1,702 | $ (80,651) | $ 111,308 |

| | Direct | Assumed | Ceded | Net |
|---|---|---|---|---|
| 2011 | | | | |
| Premiums written | $ 186,488 | $ 1,504 | $ (79,423) | $ 108,569 |
| Change in unearned premiums | (10,988) | (200) | (1,726) | (12,914) |
| Premiums earned | $ 175,500 | $ 1,304 | $ (81,149) | $ 95,655 |

**Note B - Insurance Activity (Continued)**

Activity in the liability for losses and loss adjustment expenses is summarized as follows *(in thousands)*:

| | 2012 | 2011 |
|---|---|---|
| Gross balance, beginning of year | $ 680,650 | $ 801,392 |
| Less: reinsurance recoverables | (375,604) | (411,268) |
| Net balance, beginning of year | 305,046 | 390,124 |
| Incurred related to: | | |
| Current year | 87,344 | 73,477 |
| Prior years | 55,223 | (25,349) |
| Change in related tail coverage | 13,198 | (258) |
| Total incurred | 155,765 | 47,870 |
| Paid related to: | | |
| Current year | 1,229 | 893 |
| Prior years | 38,518 | 132,055 |
| Total paid | 39,747 | 132,948 |
| Net balance, end of year | 421,064 | 305,046 |
| Plus: reinsurance recoverables | 399,670 | 375,604 |
| Gross balance, end of year | $ 820,734 | $ 680,650 |

For the year ended December 31, 2012, incurred losses attributable to events of prior years increased $55.2 million. This development relates primarily to case development on two general liability claims from the 2009 accident year.

For the year ended December 31, 2011, incurred losses attributable to events of prior years decreased $25.3 million. The 2011 decrease relates to favorable development of IBNR reserves on general liability coverage from the 2008, 2009 and 2010 accident years, which experienced less than expected claim development.

The Company uses excess of loss reinsurance to protect the Company from severe losses on the directors and officers, general partner, general liability and fiduciary liability book of business. After certain deductibles or retentions have been satisfied, the maximum amount that could be recoverable under the 2012 and 2011 reinsurance treaties is $210,000,000 with respect of general liability and $87,000,000 with respect to directors and officers, general partner and fiduciary liability.

On May 1, 2003, the Company entered into a reinsurance arrangement with Nuclear Electric Insurance Limited ("NEIL") whereby NEIL provides excess of loss reinsurance on the directors and officers and general partner book of business for 80% of $20,000,000 excess of $30,000,000.

**Note B - Insurance Activity (Continued)**

The property book of business is primarily reinsured by NEIL. In addition, the Company also has an arrangement with NEIL whereby its non-nuclear property book of business is fronted by EIM.

During 2010, EIM entered into a reinsurance agreement with Oil Casualty Insurance Limited ("OCIL") providing coverage of $25,000,000 excess of $75,000,000 for all general liability policies issued during the year. OCIL secures its obligations through a funds held and/or trust arrangements.

During 2009, EIM entered into a Reinsurance Treaty Trust Account Agreement ("Trust") with NEIL to collateralize the losses and loss adjustment expenses due EIM under reinsurance agreements. EIM has been listed as the beneficiary of the Trust. As of December 31, 2012 and 2011, the total fair value of the assets held in the Trust were $990,552,000 and $816,089,000 which collateralized $85,355,000 and $97,475,000 in reinsurance recoverables on losses and loss adjustment expenses, respectively.

Reinsurance ceded contracts do not relieve the Company from its obligations to policyholders. The Company remains liable to its policyholders for the portion reinsured, to the extent that the reinsurer does not meet the obligations assumed under the reinsurance agreement. The reinsurance recoverable on paid and unpaid losses is substantially due from NEIL and various Lloyds syndicates, comprising 42% and 29%, respectively, of the balance at December 31, 2012 and 39% and 29%, respectively, at December 31, 2011. The remaining balance comprises amounts from various reinsurers, each not exceeding 9% and 12% of the total for 2012 and 2011.

Management periodically reviews the financial condition of its existing reinsurance and concludes as to whether any allowance for uncollectible reinsurance is required. At December 31, 2012 and 2011, no such allowances were deemed necessary.

**Note C - Investments**

As of December 31, 2012, the cost, gross unrealized gains, gross unrealized losses, other-than-temporarily impaired and fair value of our fixed-maturity and equity securities are summarized as follows *(in thousands)*:

| 2012 | Cost or Amortized Cost | Other-than-temporarily Impaired | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|---|
| U.S. Treasury & Agencies | $ 60,147 | $ - | $ 636 | $ (317) | $ 60,466 |
| U.S. state and municipal obligations | 293,759 | - | 18,771 | (269) | 312,261 |
| Corporate debt securities | 195,176 | - | 13,404 | (120) | 208,460 |
| Mortgage-backed securities | 371,870 | (14,711) | 10,810 | (1,134) | 366,835 |
| Total fixed-maturity securities | 920,952 | (14,711) | 43,621 | (1,840) | 948,022 |
| Domestic equities | 115,707 | (3,944) | 121,264 | (319) | 232,708 |
| Foreign equities | 77,221 | (1,063) | 48,820 | (4,087) | 120,891 |
| Total equities | 192,928 | (5,007) | 170,084 | (4,406) | 353,599 |
| Total investments | $ 1,113,880 | $ (19,718) | $ 213,705 | $ (6,246) | $ 1,301,621 |

As of December 31, 2011, the cost, gross unrealized gains, gross unrealized losses, other-than-temporarily impaired and fair value of our fixed-maturity and equity securities are summarized as follows *(in thousands)*:

| 2011 | Cost or Amortized Cost | Other-than-temporarily Impaired | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|---|
| U.S. Treasury & Agencies | $ 136,537 | $ - | $ 6,869 | $ (6) | $ 143,400 |
| U.S. state and municipal obligations | 197,264 | (154) | 11,285 | (151) | 208,244 |
| Corporate debt securities | 150,395 | - | 7,554 | (840) | 157,109 |
| Mortgage-backed securities | 276,126 | (17,597) | 7,611 | (1,441) | 264,699 |
| Total fixed-maturity securities | 760,322 | (17,751) | 33,319 | (2,438) | 773,452 |
| Domestic equities | 167,779 | (8,069) | 109,046 | (5,070) | 263,686 |
| Foreign equities | 95,870 | (6,483) | 36,268 | (13,154) | 112,501 |
| Total equities | 263,649 | (14,552) | 145,314 | (18,224) | 376,187 |
| Total investments | $ 1,023,971 | $ (32,303) | $ 178,633 | $ (20,662) | $ 1,149,639 |

The minimum requirement of the Company's investment guidelines is that no more than 5% of all debt securities may have a below investment-grade bond rating by at least one nationally recognized credit rating agency or the equivalent to the extent possible to determine. As of December 31, 2012 and 2011, the Company is in compliance with its investment guidelines other than the securities deemed to be other-than-temporarily impaired ("OTTI").

**Note C - Investments (Continued)**

The cost and estimated fair value of fixed-maturity securities at December 31, 2012, by contractual maturity, are summarized below *(in thousands)*. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Mortgage-backed securities have been aged by their respective maturity dates.

| | Cost | Fair Value |
|---|---|---|
| Maturity: | | |
| In 2013 | $ 26,650 | $ 26,827 |
| In 2014-2017 | 171,596 | 177,677 |
| In 2018-2022 | 264,784 | 280,087 |
| Due after 2022 | 457,922 | 463,431 |
| Total fixed-maturity securities | $ 920,952 | $ 948,022 |

Proceeds from maturities of investments were approximately $30,017,000 and $79,296,000 and proceeds from sales of investments were approximately $1,189,024,000 and $2,568,799,000, during 2012 and 2011, respectively. Gross gains of approximately $56,252,000 and $42,295,000 and gross losses of $32,967,000 and $28,369,000, during 2012 and 2011 respectively, were realized on sales.

The Company regularly reviews its fixed-maturity and equity securities portfolios to evaluate the necessity of recording impairment losses for other-than-temporary declines in the fair value. In evaluating potential impairment, management considers, among other criteria: (i) the current fair value compared to amortized cost or cost, as appropriate; (ii) the length of time the security's fair value has been below amortized cost or cost; (iii) specific credit issues related to the issuer such as changes in credit rating, reduction or elimination of dividends or non-payment of scheduled interest payments; (iv) management's intent and ability to retain the investment for a period of time sufficient to allow for any anticipated recovery in value to cost; (v) specific cash flow estimations for certain mortgage-backed securities and (vi) current economic conditions.

Impaired securities are assessed when the decline in fair value is below the amortized cost basis for a specified duration. OTTI losses are recorded in the statement of income and comprehensive income as net realized losses on investments, and result in a permanent reduction of the cost basis of the underlying investment. The determination of OTTI is a subjective process, and different judgments and assumptions could affect the timing of loss realization.

**Note C - Investments (Continued)**

The following table shows the number and fair value of fixed-maturity and equity securities that the Company determined was OTTI. This resulted in recording impairment write-downs as part of net realized losses on investments for the years ended December 31, 2012 and 2011, and reduced the unrealized loss included in other comprehensive income *($ in thousands)*.

| | 2012 | | 2011 | |
|---|---|---|---|---|
| | Number | Impairment Recognized | Number | Impairment Recognized |
| Fixed-maturity securities | 2 | $ 234 | 2 | $ 543 |
| Equity securities | 3 | 320 | 13 | 3,031 |
| Total | 5 | $ 554 | 15 | $ 3,574 |

The following tables show gross unrealized losses and fair values of investments, aggregated by investment category, and the length of time that individual investments have been in a continuous unrealized loss position, at December 31, 2012 *(in thousands)*:

| | Less than one year | | One year or more | | Total | |
|---|---|---|---|---|---|---|
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| U.S. Treasury & Agencies | $ 17,464 | $ 317 | $ - | $ - | $ 17,464 | $ 317 |
| U.S. state and municipal obligations | 28,219 | 234 | 1,322 | 35 | 29,541 | 269 |
| Corporate debt securities | 21,627 | 120 | - | - | 21,627 | 120 |
| Mortgage-backed securities | 99,790 | 975 | 745 | 159 | 100,535 | 1,134 |
| Domestic equities | 3,342 | 264 | 2,222 | 55 | 5,564 | 319 |
| Foreign equities | 7,149 | 823 | 9,851 | 3,264 | 17,000 | 4,087 |
| Total temporarily impaired securities | $ 177,591 | $ 2,733 | $ 14,140 | $ 3,513 | $ 191,731 | $ 6,246 |

As of December 31, 2012, the Company had 372 fixed-maturity securities with unrealized losses. Two with aggregate unrealized losses of $30,000 were 20% or greater than the cost. As of December 31, 2011, the Company had 248 fixed-maturity securities with unrealized losses. 16 with aggregate unrealized losses of $691,000 were 20% or greater than the cost. The Company has evaluated these fixed-maturity securities and believes the unrealized losses are due primarily to temporary market and sector-related factors rather than to issuer specific-factors. Management does not intend to sell, and it is more likely than not that EIM will not be required to sell the securities before recovery. The Company does not consider these securities to be other-than-temporarily impaired.

**Note C - Investments (Continued)**

The Company's investment objective for equities is to emulate the returns of the S&P 900 and the MSCI EAFE index for its domestic and international equity portfolios, respectively. Of the 909 equity securities with unrealized losses, 425 with unrealized losses of $2,933,000 were 20% or greater than the cost and have been in a continuous loss position for longer than a year at December 31, 2012. Of the 1,992 equity securities with unrealized losses, 700 with unrealized losses of $13,905,000 were 20% or greater than the cost and have been in a continuous loss position for longer than a year at December 31, 2011. The Company has evaluated these securities based on past earnings trends, analysts' reports and analysts' earnings expectations. Management does not intend to sell, and it is more likely than not that EIM will not be required to sell the securities before recovery. The Company does not consider these securities to be other-than-temporarily impaired.

The composition of net investment income is summarized below *(in thousands)*:

| | 2012 | 2011 |
|---|---|---|
| Interest income | $ 28,603 | $ 28,261 |
| Dividend income | 10,118 | 10,794 |
| Loss from subsidiary | (267) | (28) |
| Other | (44) | (53) |
| Gross investment income | 38,410 | 38,974 |
| Investment management fees | (2,845) | (2,732) |
| Net investment income | $ 35,565 | $ 36,242 |

The Company has adopted the accounting guidance for Fair Value Measurements and Disclosures. This statement provides guidance for measuring assets and liabilities at fair value. The market approach was the valuation technique used to measure fair value of the investment portfolio. The market approach was used to value EIM's equity and fixed-maturity securities.

The Company's estimates of fair value for financial assets and financial liabilities are based on the framework established in the Fair Value Measurements and Disclosures accounting guidance. The framework is based on the inputs used in valuation and requires that observable inputs be used in the valuations when available. The disclosure of fair value estimates in the fair value accounting guidance includes a hierarchy based on whether significant valuation inputs are observable. In determining the level of the hierarchy in which the estimate is disclosed, the highest priority is given to unadjusted quoted prices in active markets and the lowest priority to unobservable inputs that reflect the Company's significant market assumptions. The three levels of the hierarchy are as follows:

> **Level 1** – Inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities traded in active markets. Included are those investments traded on an active exchange, such as the NASDAQ Global Select Market.

**Note C - Investments (Continued)**

**Level 2** – Inputs to the valuation methodology include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability and market-corroborated inputs. Included are investments in U.S. Treasury securities and obligations of U.S. government agencies, together with municipal bonds, corporate debt securities, commercial mortgage and asset-backed securities, certain residential mortgage-backed securities that are generally investment grade and certain equity securities.

**Level 3** – Inputs to the valuation methodology are unobservable for the asset or liability and are significant to the fair value measurement. Material assumptions and factors considered in pricing investment securities may include projected cash flows, collateral performance including delinquencies, defaults and recoveries, and any market clearing activity or liquidity circumstances in the security or similar securities that may have occurred since the prior pricing period. Generally included in this valuation methodology are investments in certain mortgage-backed and asset-backed securities.

Fair values are based on quoted market prices when available (Level 1). The Company receives the quoted market prices from a third party, nationally recognized pricing service ("pricing service"). When market prices are not available, the Company utilizes a pricing service to determine an estimate of fair value, which is mainly used for its fixed-maturity investments fair value. The fair value is generally estimated using current market inputs for similar financial instruments with comparable terms and credit quality, commonly referred to as matrix pricing (Level 2). In instances where there is little or no market activity for the same or similar instruments, the Company estimates fair value using methods, models and assumptions that management believes are relevant to the particular asset or liability. This may include discounted cash flow analysis or other income based approaches (Level 3). These valuation techniques involve some level of management estimation and judgment. Where appropriate, adjustments are included to reflect the risk inherent in a particular methodology, model or input used and are reflective of the assumptions that market participants would use in valuing assets or liabilities.

The following table presents the Company's investment securities within the fair value hierarchy, and the related inputs used to measure those securities at December 31, 2012 *(in thousands)*:

| | Total | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| Fixed-maturity | $ 948,022 | $ - | $ 948,022 | $ - |
| Equities | 353,599 | 353,599 | - | - |
| Total | $ 1,301,621 | $ 353,599 | $ 948,022 | $ - |

There were no transfers between fair value levels during 2012 and 2011.

**Note C - Investments (Continued)**

Several of EIM's policyholders are companies represented in the S&P 900. Consequently, at December 31, 2012 and 2011, EIM holds investments with a total fair value of approximately $22.4 and $31.3 million, respectively, in issuers who are policyholders.

**Note D - Federal Income Taxes**

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31 are as follows *(in thousands)*:

| | 2012 | 2011 |
|---|---|---|
| Deferred tax assets: | | |
| Unpaid losses and loss adjustment expenses | $ 13,228 | $ 10,397 |
| Unearned premiums | 4,851 | 4,466 |
| Accrued expenses | 2,205 | 1,423 |
| Unrealized comprehensive losses in earnings | 7,136 | 11,306 |
| Net operating loss carryforward | 2,446 | - |
| Total deferred tax assets | 29,866 | 27,592 |
| Deferred tax liabilities: | | |
| Unrealized capital gains | 72,610 | 55,290 |
| Premium amortization | 1,302 | 1,923 |
| Other | 1,087 | 1,336 |
| Total deferred tax liabilities | 74,999 | 58,549 |
| Net deferred tax liability | $ (45,133) | $ (30,957) |

The provision for federal income tax differs from the amount derived by applying the statutory federal tax rates to pretax income for financial reporting purposes due primarily to tax exempt investment income.

The Company is required to establish a "valuation allowance" for any portion of the deferred tax asset that management believes will not be realized. The Company has historically been a taxpayer, and in the opinion of management, will continue to be in the future. Because management believes that it is more likely than not that the Company will realize the benefit of the deferred tax asset, no valuation allowance has been established.

During 2003, the Company applied for, and was granted an exemption from Barbados income tax by the Minister of Finance under the Duties, Taxes and Other Payment (Exemption) Act.

**Note D - Federal Income Taxes (Continued)**

At December 31, 2012 and 2011, the Company determined there are no material unrecognized tax benefits, and no adjustments to liabilities or operations were required.

Tax years 2008 through 2012 are subject to examination by the Internal Revenue Service.

**Note E - Commitments and Contingencies**

The Company is named as defendant in various legal actions arising in the normal course of business from claims made under insurance policies and contracts. These actions are considered by the Company in estimating the loss and loss adjustment expense reserves. The Company's management believes that the resolution of these actions will not have a material adverse effect on the Company's financial position or results of operations.

**Note F - Trust Funds and Deposits**

The Company has established a trust fund with a federally insured depository. This trust fund serves as security for policyholders and third-party claimants to satisfy requirements of being listed as an alien surplus lines insurer by the National Association of Insurance Commissioners. The Company is required to maintain a minimum amount of the lesser of \$100,000,000 or \$5,400,000 plus 30% for liabilities arising from business on or after January 1, 1998. At December 31, 2012 and 2011, the required balance was \$100,000,000. In addition, the state of Florida has required the Company to deposit \$300,000 as security for the Company's policyholders and creditors. The trust funds and deposit balances have been included in the accompanying balance sheets as available-for-sale investments, including both fixed-maturity securities and equities.

**Note G - Line of Credit**

A line of credit was established on July 22, 2011 in the amount of \$50,000,000. The letter of credit was to be used solely to fund claim payments that are subject to reinsurance recovery. There were no amounts drawn on the line at December 31, 2012 and 2011.

**Note H - Retiree Medical Benefits**

The Company provides employees with a Post-retirement Medical, Dental and Vision Plan ("the Plan"). The Plan is available to retirees (upon fulfilling eligibility requirements), their spouses and dependents as a continuation of the healthcare plan available to active employees. Currently the benefits are self insured, with a third party stop-loss reinsurance arrangement. Retirees are not required to make contributions for coverage. The Plan is unfunded.

The assumed discount rate used to determine the benefit obligation is 4.45% for 2012. The assumed healthcare cost trend rate is 7.50% for 2013, trending to 4.5% by 2027. The Company has recognized a liability representing the accumulated post-retirement benefit obligation in the amount of $6,300,000 as of December 31, 2012. The Company recognized a liability representing the actuarially determined accumulated post-retirement benefit obligation in the amount of $4,067,000 as of December 31, 2011.

**Note I - Margin of Solvency**

In order to meet the requirements of the Qualifying Insurance Company under the Insurance Act 1992-2 of Barbados, the Company must have contributed reserves of approximately $12 million. The policyholders' surplus provided an excess margin of solvency of approximately $811 million at December 31, 2012.