

UNION HAMILTON REINSURANCE, LTD.
(A wholly-owned subsidiary of Wells Fargo & Company)

FINANCIAL STATEMENTS

As of December 31, 2020 and 2019,
and for the Years then Ended

(With Independent Auditors' Report Thereon)



KPMG LLP
Suite 1000
620 S. Tryon Street
Charlotte, North Carolina 28202-1842

Independent Auditors' Report

The Board of Directors
Union Hamilton Reinsurance, Ltd.:

We have audited the accompanying financial statements of Union Hamilton Reinsurance, Ltd., which comprise the balance sheets as of December 31, 2020 and 2019, and the related statements of income, comprehensive income, changes in stockholders' equity, and cash flows for the 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 U.S. generally accepted accounting principles; 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.

Auditors' 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 audit 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 auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the 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 Union Hamilton Reinsurance, Ltd. as of December 31, 2020 and 2019, and the results of its operations and its cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

KPMG LLP

Charlotte, North Carolina
May 25, 2021

UNION HAMILTON REINSURANCE, LTD.
(A wholly-owned subsidiary of Wells Fargo & Company)

BALANCE SHEETS

December 31, 2020 and 2019

| (\$ in thousands, except par value and shares) | 2020 | 2019 |
|--|--------------|--------------|
| ASSETS | | |
| Cash and cash equivalents | \$ 179,603 | \$ 264,327 |
| Total cash, cash equivalents, and restricted cash | 179,603 | 264,327 |
| Debt securities - available-for-sale | \$ 2,202,226 | \$ 2,327,582 |
| Reinsurance fee receivable | 11,128 | 13,990 |
| Reinsurance premiums receivable | 82,857 | 82,941 |
| Value of business acquired | 20,007 | 23,214 |
| Deferred acquisition costs | 7,433 | 8,418 |
| Affiliate receivable | 2,674 | 3,390 |
| Investment income due and accrued | 8,364 | 14,571 |
| Intercompany note receivable | 84,147 | 294,132 |
| Income taxes receivable | — | 20,265 |
| Other receivables | 6,566 | 6,538 |
| Total assets | \$ 2,605,005 | \$ 3,059,368 |
| LIABILITIES AND STOCKHOLDER'S EQUITY | | |
| Liability for future policy benefits | \$ 556,158 | \$ 463,458 |
| Income taxes payable | 58,183 | — |
| Embedded derivatives liabilities | 26,517 | 17,200 |
| Interest payable | — | 34 |
| Affiliate payable | 147 | 624 |
| Accounts payable | 877 | 225 |
| Deferred tax liabilities, net | 39,140 | 91,561 |
| Total liabilities | 681,022 | 573,102 |
| Stockholder's equity: | | |
| Common stock, \$1.00 par value; 1,000,000 shares authorized, issued and outstanding | 1,000 | 1,000 |
| Paid-in capital | 1,291,656 | 1,396,656 |
| Retained earnings | 605,941 | 1,063,132 |
| Accumulated other comprehensive income, net | 25,386 | 25,478 |
| Total stockholder's equity | 1,923,983 | 2,486,266 |
| Total liabilities and stockholder's equity | \$ 2,605,005 | \$ 3,059,368 |

See accompanying notes to financial statements.

UNION HAMILTON REINSURANCE, LTD.
(A wholly-owned subsidiary of Wells Fargo & Company)

STATEMENTS OF INCOME

Years Ended December 31, 2020 and 2019

| (\$ in thousands) | 2020 | 2019 |
|---|------------|------------|
| INCOME | | |
| Net reinsurance premiums earned | \$ 194,222 | \$ 198,622 |
| Reinsurance fee income | 48,645 | 59,409 |
| Interest income | 57,720 | 102,409 |
| Net (loss) gain on embedded derivatives | (9,373) | 11,808 |
| Net gain (loss) on economic hedges | 2,534 | (15,867) |
| Realized loss on sale of securities, net | (293) | — |
| Other miscellaneous income | 15 | 17 |
| Total income | 293,470 | 356,398 |
| BENEFITS AND EXPENSES | | |
| Amortization of deferred acquisition costs / value of business acquired | 4,192 | 4,585 |
| Change in liability for future policy benefits | 97,501 | 96,138 |
| Interest expense | (21) | 595 |
| Affiliate expense | 11,840 | 17,027 |
| General expense | 4,837 | 4,410 |
| Total benefits and expenses | 118,349 | 122,755 |
| Income before income tax expense | 175,121 | 233,643 |
| Federal and state income tax expense | 37,308 | 49,179 |
| Net income | \$ 137,813 | \$ 184,464 |

See accompanying notes to financial statements.

UNION HAMILTON REINSURANCE, LTD.
(A wholly-owned subsidiary of Wells Fargo & Company)

STATEMENTS OF COMPREHENSIVE INCOME

Years ended December 31, 2020 and 2019

| (\$ in thousands) | 2020 | 2019 |
|---|-------------------|-------------------|
| Net income | \$ 137,813 | \$ 184,464 |
| Other comprehensive income (loss), before tax: | | |
| Securities available for sale: | | |
| Net unrealized gains (losses) arising during the period | (409) | 47,155 |
| Reclassification of net loss to net income, before tax | 293 | — |
| Other comprehensive income (loss), before tax | (116) | 47,155 |
| Income tax expense (benefit) related to other comprehensive income | (24) | 9,902 |
| Other comprehensive income (loss), net of tax | (92) | 37,253 |
| Total comprehensive income | \$ 137,721 | \$ 221,717 |

See accompanying notes to financial statements.

UNION HAMILTON REINSURANCE, LTD.
(A wholly-owned subsidiary of Wells Fargo & Company)

STATEMENTS OF CHANGES IN STOCKHOLDER'S EQUITY

December 31, 2020 and 2019

| (\$ in thousands) | Common stock | Paid-in capital | Retained earnings | Accumulated other comprehensive (loss) income, net | Total stockholder's equity |
|---|-----------------|---------------------|----------------------|--|----------------------------------|
| Balance, December 31, 2018 | \$ 1,000 | \$ 1,396,656 | \$ 878,686 | \$ (11,775) | \$ 2,264,567 |
| Cummulative change in accounting policy (1) | — | — | (18) | — | (18) |
| Comprehensive income: | | | | | |
| Net income | — | — | 184,464 | — | 184,464 |
| Unrealized gain on securities, net of reclassification adjustments and deferred income tax expense of \$9,902 | — | — | — | 37,253 | 37,253 |
| Total comprehensive income | | | | | 221,717 |
| Balance, December 31, 2019 | \$ 1,000 | \$ 1,396,656 | \$ 1,063,132 | \$ 25,478 | \$ 2,486,266 |
| Cummulative change in accounting policy (2) | — | — | (4) | — | (4) |
| Dividends and return of capital | — | (105,000) | (595,000) | — | (700,000) |
| Comprehensive income: | | | | | |
| Net income | — | — | 137,813 | — | 137,813 |
| Unrealized gain on securities, net of reclassification adjustments and deferred income tax benefit of \$24 | — | — | — | (92) | (92) |
| Total comprehensive income | | | | | 137,721 |
| Balance, December 31, 2020 | \$ 1,000 | \$ 1,291,656 | \$ 605,941 | \$ 25,386 | \$ 1,923,983 |

(1) Effective January 1, 2019, the Company adopted ASU 2017-08 - Receivables- Nonrefundable Fees and Other Costs (subtopic 310-20): *Premium Amortization on Purchased Callable Debt Securities*

(2) Effective January 1, 2020, the Company adopted ASU 2016-13 – Financial Instruments – Credit Losses (Topic326): *Measurement of Credit Losses on Financial Instruments* and related subsequent updates, See Note 2.

See accompanying notes to financial statements.

UNION HAMILTON REINSURANCE, LTD.
(A wholly-owned subsidiary of Wells Fargo & Company)

STATEMENTS OF CASH FLOWS

December 31, 2020 and 2019

| (\$ in thousands) | 2020 | 2019 |
|---|------------|------------|
| OPERATING ACTIVITIES | | |
| Net income | \$ 137,813 | \$ 184,464 |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: | | |
| Deferred income taxes | (52,395) | (52,479) |
| Accretion and amortization of securities discounts and premiums, net | (298) | (1,529) |
| Provision for Debt Securities AFS Accumulated Credit Loss | 1,743 | — |
| Hedge revaluations | (18,693) | (19,077) |
| Realized loss on securities, net of OTTI | 293 | — |
| Changes in: | | |
| Reinsurance fee receivable | 2,862 | (40) |
| Reinsurance premiums receivable | 84 | 628 |
| Value of business acquired/deferred acquisition costs | 4,192 | 4,585 |
| Affiliate receivable | 716 | 9,410 |
| Interest income due and accrued | 6,207 | 6,177 |
| Other receivables | (28) | 13 |
| Liability for future policy benefits | 92,700 | 93,426 |
| Interest payable | (34) | (296) |
| Affiliate payable | (477) | (1,178) |
| Accounts payable | 652 | (1) |
| Income taxes receivable/payable | 78,448 | (10,612) |
| Embedded derivative liability | 9,317 | (10,423) |
| Net cash provided by operating activities | 263,102 | 203,068 |
| INVESTING ACTIVITIES | | |
| Proceeds from paydowns of securities | 551,304 | 399,135 |
| Purchases of securities - available-for-sale | (430,446) | (27,843) |
| Sale of securities - available-for-sale | 21,331 | — |
| Net cash provided by (used in) investing activities | 142,189 | 371,292 |
| FINANCING ACTIVITIES | | |
| Intercompany note to affiliate | 209,985 | (294,132) |
| Payments of Intercompany Debt to Parent | — | (100,140) |
| Cash dividends paid | (595,000) | — |
| Return of capital | (105,000) | — |
| Net cash used in financing activities | (490,015) | (394,272) |
| Net decrease in cash, cash equivalents, and restricted cash | (84,724) | 180,088 |
| Cash, cash equivalents and restricted cash, beginning of year | 264,327 | 84,239 |
| Cash, cash equivalents, and restricted cash, end of year | \$ 179,603 | \$ 264,327 |
| CASH PAID FOR (RECEIVED) | | |
| Interest paid on intercompany debt to parent | \$ — | \$ 581 |
| Interest received on intercompany receivable from parent | (6,740) | (3,168) |
| Income taxes paid | 11,255 | 112,276 |

See accompanying notes to financial statements.

UNION HAMILTON REINSURANCE, LTD.
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NOTES TO THE FINANCIAL STATEMENTS

December 31, 2020 and 2019

NOTE 1: GENERAL

Union Hamilton Reinsurance, Ltd. (the Company) was incorporated in Bermuda on December 11, 2000, and is a direct, wholly-owned subsidiary of Wells Fargo & Company (Wells Fargo or Parent), a Delaware Corporation. The Company engages in reinsurance activities. Reinsurance is an arrangement under which an insurance company, the reinsurer, agrees to indemnify another insurance company, the ceding company, for all or a portion of the insurance risks underwritten by the ceding company. The Company has entered into specific transactions that are described further in Note 5 in which it reinsures annuities and certain risks associated with life insurance contracts.

On December 29, 2020, the Company returned \$105,000,000 of capital and paid dividends of \$595,000,000 to its parent.

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BASIS OF PRESENTATION

The Company's accounting and reporting policies conform with U.S. generally accepted accounting principles (GAAP). To prepare the financial statements in conformity with GAAP, management must make estimates based on assumptions about future economic and market conditions that affect the reported amounts of assets and liabilities at the date of the financial statements and income and expenses during the reporting period and the related disclosures. Although the Company's estimates contemplate current conditions and how we expect them to change in the future, it is reasonably possible that actual conditions could be better or worse than anticipated in those estimates, which could materially affect results of operations and financial condition.

All dollar amounts except per share amounts on the financial statements and tables are presented in thousands. All dollar amounts in the notes are presented in whole dollars, unless otherwise stated. Due to rounding to thousands, there can be slight differences between values on the financial statements and tables when compared to the notes.

DEBT SECURITIES

Debt securities that the Company might not hold until maturity are classified as available-for-sale (AFS) securities and reported at fair value. Unrealized gains and losses, after applicable income taxes, are reported in accumulated other comprehensive income (OCI).

Unamortized premiums and discounts are recognized in interest income over the contractual life of the security using the effective interest method, except for purchased callable debt securities carried at a premium. For purchased callable debt securities carried at a premium, the premium is amortized into interest income to the next call date using the effective interest method. As principal repayments are received on securities (e.g., mortgage-backed securities (MBS)), a proportionate amount of the related premium or discount is recognized in income so that the effective interest rate on the remaining portion of the security continues unchanged.

The Company recognizes realized gains and losses on the sale of debt securities in net gains on trading and securities within noninterest income using the specific identification method.

(Continued)

UNION HAMILTON REINSURANCE, LTD.
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NOTES TO THE FINANCIAL STATEMENTS

December 31, 2020 and 2019

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Unrealized losses on AFS debt securities are driven by a number of factors, including changes in interest rates and credit spreads which impact most types of debt securities, and prepayment rates which impact MBS and collateralized loan obligations (CLO). Additional considerations for certain types of AFS debt securities include:

- Debt securities of U.S. Treasury and federal agencies, including federal agency MBS, are not impacted by credit movements given the explicit or implicit guarantees provided by the U.S. government.
- Debt securities of U.S. states and political subdivisions are most impacted by changes in the relationship between municipal and term funding credit curves rather than by changes in the credit quality of the underlying securities.
- Structured securities, such as MBS and CLO, are also impacted by changes in projected collateral losses of assets underlying the security.

For AFS debt securities where fair value is less than amortized cost basis, the Company recognizes impairment in earnings if the Company has the intent to sell the security or if it is more likely than not that the Company will be required to sell the security before recovery of its amortized cost basis. Impairment is recognized in net gains on trading and securities within noninterest income equal to the entire difference between the amortized cost basis, net of the allowance for credit losses (ACL), and the fair value of the AFS debt security. Following the recognition of this impairment, the AFS debt security's new amortized cost basis is fair value.

For AFS debt securities where fair value is less than amortized cost basis where we did not recognize impairment in earnings, we record an ACL as of the balance sheet date to the extent unrealized loss is due to credit losses. See the Note 3 relating to the ACL for debt securities.

Allowance for Credit Losses

The Company maintains an ACL for AFS debt securities measured at amortized costs. While the Company attributes portions of the allowance to specific financial asset classes (debt security portfolios), the entire ACL is available to absorb credit losses of the Company.

The Company's ACL process involves procedures to appropriately consider the unique risk characteristics of the Company's major security types. For AFS debt securities, losses are estimated at the individual security level.

The Company's approach for estimating expected lifetime credit losses for debt securities includes utilizing discounted cash flow (DCF) methods to measure the ACL. The DCF methods obtain estimated lifetime credit losses using the initial and historical mean loss forecast periods with initial forecast period of two years.

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UNION HAMILTON REINSURANCE, LTD.
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NOTES TO THE FINANCIAL STATEMENTS

December 31, 2020 and 2019

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

The ACL for financial assets held at amortized cost is a valuation account that is deducted from, or added to, the amortized cost basis of the financial assets to present the net amount expected to be collected. When credit expectations change, the valuation account is adjusted with changes reported in provision for credit losses. If amounts previously charged off are subsequently expected to be collected, the Company may recognize a negative allowance, which is limited to the amount that was previously charged off. For financial assets with an ACL estimated using DCF methods, changes in the ACL due to the passage of time are recorded in interest income. The ACL for AFS debt securities reflects the amount of unrealized loss related to expected credit losses, limited by the amount that fair value is less than the amortized cost basis (fair value floor) and cannot have an associated negative allowance.

For certain financial assets, such as residential real estate loans guaranteed by the Government National Mortgage Association (GNMA), an agency of the federal government, U. S. Treasury and Agency mortgage backed debt securities, as well as certain sovereign debt securities, the Company has not recognized an ACL as our expectation of nonpayment of the amortized cost basis, based on historical losses, adjusted for current and forecasted conditions, is zero.

The Company does not generally record an ACL for accrued interest receivables because uncollectible accrued interest is reversed through interest income in a timely manner in line with our nonaccrual and past due policies for loans and debt securities.

CASH AND CASH EQUIVALENTS

Cash and cash equivalents may include cash on deposit, money market funds and certificates of deposit with maturities of less than 90 days from acquisition (see Note 3).

DEFERRED ACQUISITION COSTS AND VALUE OF BUSINESS ACQUIRED

The Company incurs significant costs in connection with acquiring new reinsurance business. The Company records the reimbursement of first year acquisition costs as deferred acquisition costs (DAC).

DAC consists of ceding commissions and other acquisition expenses that are amortized using the effective interest method. DAC is regularly reviewed to determine if it is recoverable from future premium income, including investment income, by evaluating whether or not a loss is probable on the unexpired portion of policies in force. A premium deficiency loss is recognized when it is probable that expected future claims will exceed anticipated future premiums and anticipated investment income.

The value of business acquired (VOBA) is the intangible asset representing the fair value assigned to annuity reinsurance contracts inforce at the time of a business combination. VOBA is amortized over the expected life of the contracts using the effective interest method. The carrying value is reviewed at least annually for possible impairment in value (see Note 6).

(Continued)

UNION HAMILTON REINSURANCE, LTD.
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NOTES TO THE FINANCIAL STATEMENTS

December 31, 2020 and 2019

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

DERIVATIVES

Economic hedge assets and liabilities include derivatives such as equity futures, equity options, and interest rate swaps. These economic hedges are recorded at fair value in economic hedges - assets and liabilities on the balance sheets with realized and unrealized gains and losses recorded in net gain (loss) on economic hedges in the statements of income. The fair value of derivatives in a gain position is reported as economic hedge assets and the fair value of derivatives in a loss position is reported as economic hedge liabilities (see Notes 7 and 8).

HEDGING ACTIVITIES

The Company uses derivatives to hedge interest rate risk and recognizes all derivatives on the balance sheet at fair value. On the date the Company enters into a derivative contract, the Company designates the derivative as qualifying for hedge accounting in a hedge of the fair value of a recognized asset or liability or an unrecognized firm commitment ("fair value hedge"). For derivatives not designated as a fair value hedge, the Company reports changes in the fair values in current period noninterest income.

For fair value hedges qualifying for hedge accounting, the Company formally documents at inception the relationship between hedging instruments and hedged items, the Company's risk management objective, strategy and the Company's evaluation of effectiveness for the Company's hedge transactions. This process includes linking all derivatives designated as fair value to specific assets and liabilities on the balance sheet or to specific forecasted transactions. The Company assesses hedge effectiveness using regression analysis, both at inception of the hedging relationship and on an ongoing basis. For fair value hedges, the regression analysis involves regressing the periodic change in fair value of the hedging instrument against the periodic changes in fair value of the asset or liability being hedged due to changes in the hedged risk(s). The assessment for fair value hedges includes an evaluation of the quantitative measures of the regression results used to validate the conclusion of high effectiveness. Periodically, as required, the Company also formally assesses whether the derivative the Company designated in each hedging relationship is expected to be and has been highly effective in offsetting changes in fair values of the hedged item using the regression analysis method.

For a fair value hedge, the Company records changes in the fair value of the derivative and the hedged asset or liability due to the hedged risk in current period net income, except for certain derivatives in which a portion is recorded to OCI. The Company presents derivative gains or losses in the same income statement category as the hedged asset or liability. For fair value hedges of interest rate risk, amounts are reflected in net interest income.

(Continued)

UNION HAMILTON REINSURANCE, LTD.
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NOTES TO THE FINANCIAL STATEMENTS

December 31, 2020 and 2019

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

The Company discontinues hedge accounting prospectively when (1) a derivative is no longer highly effective in offsetting changes in the fair value or cash flows of a hedged item, (2) a derivative expires or is sold, terminated or exercised, or (3) the Company elects to discontinue the designation of a derivative as a hedge. When the Company discontinues fair value hedge accounting, the Company no longer adjusts the previously hedged asset or liability for changes in fair value, and remaining cumulative adjustments to the hedged item are accounted for in the same manner as other components of the carrying amount of the asset or liability. If the derivative continues to be held after fair value hedge accounting ceases, the Company carries the derivative on the balance sheet at its fair value with changes in fair value included in noninterest income (see Notes 7 and 8).

EMBEDDED DERIVATIVE LIABILITIES

The Company reinsures certain annuity products that contain contract riders that are deemed to be embedded derivatives, specifically, variable annuities with guaranteed minimum benefits. The Company assesses each identified embedded derivative and bifurcates it from the host contract as required under Derivatives and Hedging (Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 815). Such embedded derivatives are carried on the balance sheets at fair value and included in embedded derivative liabilities. Changes in the fair value of embedded derivatives are recorded in net gain or loss on embedded derivatives in the statements of income. The Company's hedging strategy is designed to mitigate the volatility associated with its reinsurance of variable annuities with guaranteed minimum benefits. The strategy is designed so that the fair value of the hedge contracts, primarily equity options, equity futures and interest rate swaps, economically offsets changes in the fair value of the embedded derivatives (see Notes 7 and 8).

COUNTERPARTY CREDIT RISK AND NETTING

By using derivatives, the Company is exposed to counterparty credit risk, which is the risk that counterparties to the derivative contracts do not perform as expected. If a counterparty fails to perform, our counterparty credit risk is equal to the amount reported as a derivative asset on our balance sheet. The amounts reported as a derivative asset are derivative contracts in a gain position, and to the extent subject to legally enforceable master netting arrangements, net of derivatives in a loss position with the same counterparty and cash collateral received. The Company minimizes counterparty credit risk through credit approvals, limits, monitoring procedures, executing master netting arrangements and obtaining collateral, where appropriate. Counterparty credit risk related to derivatives is considered in determining fair value and the Company's assessment of hedge effectiveness. Consistent with the Parent company's counterparty netting policy, the Company received approval from internal legal counsel in 2017 that the netting provision of the master netting agreement between Wells Fargo Bank, N.A. and the Company was valid and binding. To the extent derivatives subject to master netting arrangements meet the applicable requirements, including determining the legal enforceability of the arrangement, it is the Company's policy to present derivative balances and related cash collateral amounts net on the balance sheet. For additional information on our derivatives and hedging activities, (see Notes 7 and 8).

(Continued)

UNION HAMILTON REINSURANCE, LTD.
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NOTES TO THE FINANCIAL STATEMENTS

December 31, 2020 and 2019

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

REINSURANCE

The Company enters into reinsurance agreements with direct underwriters for surplus relief and stop loss reinsurance, as well as variable annuity agreements. Reinsurance premiums and reserves related to reinsured business are accounted for on a basis consistent with that used in accounting for the original policies issued and the terms of the reinsurance contracts. The retroceding of insurance does not discharge the Company from its responsibility to the reinsured. See Note 5 for further discussion.

INCOME TAXES

The Company is part of a consolidated U.S. federal income tax return. The group utilizes a tax allocation method that allocates tax expense among members of the consolidated group using a modified separate return method. The separate return method has been modified such that each subsidiaries' net operating losses and capital losses are considered realized by the subsidiary in its separate financial statements when those net operating losses are used by the parent in its consolidated tax return with a cash settlement at that time. The separate return method, modified in the manner described above, provides a systematic, rational approach to allocating current and deferred income tax expense among the members of the group and is consistent with the broad principles established in ASC Topic 740.

The Company evaluates two components of income tax expense: current and deferred income tax expense. Current income tax expense represents estimated taxes to be paid or refunded for the current period and includes income tax expense related to uncertain tax positions. Uncertain tax positions that meet the more likely than not recognition threshold are measured to determine the amount of benefit to recognize. An uncertain tax position is measured at the largest amount of benefit that management believes has a greater than 50% likelihood of realization upon settlement. Tax benefits not meeting our realization criteria represent unrecognized tax benefits.

Deferred income tax expense results from changes in deferred tax assets and liabilities between periods. The Company determines deferred income taxes using the balance sheet method. Under this method, the net deferred tax asset or liability is based on the tax effects of the differences between the book and tax basis of assets and liabilities, and enacted changes in tax rates and laws are recognized in the period in which they occur. Deferred tax assets are recognized subject to management's judgment that realization is more likely than not. See Note 9 for further discussion.

(Continued)

UNION HAMILTON REINSURANCE, LTD.
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NOTES TO THE FINANCIAL STATEMENTS

December 31, 2020 and 2019

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

ADOPTED ACCOUNTING STANDARDS

ASU 2016-13 – Financial Instruments – Credit Losses (Topic 326): *Measurement of Credit Losses on Financial Instruments*. The Update changes the accounting for credit losses on debt securities and reinsurance receivables. The Update modifies the other-than-temporary impairment model for available-for-sale debt securities to require an allowance for credit impairment instead of a direct write-down, which allows for reversal of credit impairments in future periods based on improvements in credit. The guidance is effective in the first quarter of 2020, with a cumulative-effect adjustment to retained earnings as of the beginning of the year of adoption. The Company recognized an allowance for credit loss of \$5,468, as a cumulative effect adjustment from change in accounting policies. The adjustment is net of income taxes.

ASU 2020-04- Reference Rate Reform (Topic 848): *Facilitation of the Effects of Reference Rate Reform on Financial Reporting*. The Update provides optional, temporary relief to ease the burden of accounting for reference rate reform activities that affect contractual modifications of floating rate financial instruments indexed to interbank offering rates (IBORs) and hedge accounting relationships. Modifications of qualifying contracts are accounted for as the continuation of an existing contract rather than as a new contract. Modifications of qualifying hedging relationships will not require discontinuation of the existing hedge accounting relationships. The application of the relief for qualifying existing hedging relationships may be made on a hedge-by-hedge basis and across multiple reporting periods.

ASU 2020-04 was adopted in the second quarter of 2020, and the guidance will be followed until the update terminates on December 31, 2022. This guidance is applied on a prospective basis. The update did not have a material impact on the financial statements.

ASU 2018-13- Fair Value Measurement (Topic 820) *Disclosure Framework Changes to the Disclosed Requirement for Fair Value Measurement*. The update clarifies, eliminates and adds certain fair value measurement disclosure requirements for assets and liabilities, which affects disclosures in Note 8 (Fair Values of Assets and Liabilities). Although the ASU became effective on January 1, 2020, it permitted early adoption of individual requirements without causing others to be early adopted and, as such, the Company partially adopted the update during the third quarter 2018 and the remained of the requirement in the first quarter of 2020. The update did not have a material impact on the financial statements.

(Continued)

UNION HAMILTON REINSURANCE, LTD.
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NOTES TO THE FINANCIAL STATEMENTS

December 31, 2020 and 2019

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

SUBSEQUENT EVENTS

We have evaluated the effects of subsequent events that have occurred subsequent to the period end December 31, 2020 and through May 25, 2021, which is the date we issued our financial statements.

All but one of the Company's surplus relief reinsurance transactions was terminated in the first quarter of 2021.

On April 21, 2021, UHRL purchased securities with a market value of \$56,312,964 from FNL Insurance Company, an affiliate, and sold securities with a market value of \$443,899,502 to FNL Insurance Company.

In May 2021, the Company amended its lending agreement with WFC Holding, LLC. Terms of this agreement now allow WFC Holding LLC to borrow up to \$1.2 billion.

NOTE 3: DEBT SECURITIES - AVAILABLE-FOR-SALE

The following table provides the amortized cost and fair value by major categories of available-for-sale securities at December 31, 2020 and 2019. For 2020, the amortized cost, unrealized gains, and unrealized losses are presented net of ACL.

| (\$ in thousands) | Amortized cost (1) | Gross unrealized gains | Gross unrealized losses | Fair value |
|--|-----------------------|------------------------------|-------------------------------|---------------------|
| December 31, 2020: | | | | |
| Securities of U.S. Treasury and federal agencies | \$ 414,867 | \$ 1,132 | \$ - | \$ 415,999 |
| Federal agency mortgage-backed securities | 337,160 | 13,623 | - | 350,783 |
| Commercial mortgage-backed securities | 48,188 | - | (994) | 47,194 |
| Collateralized debt obligations | 858,831 | 484 | (3,418) | 855,897 |
| Corporate debt securities | 497,590 | 21,995 | (2,814) | 516,771 |
| Other debt securities | 15,286 | 307 | (11) | 15,582 |
| Total debt securities | \$ 2,171,922 | \$ 37,541 | \$ (7,237) | \$ 2,202,226 |

(1) Represents amortized cost of the securities, net of the ACL of \$1.8 million related to AFS debt securities at December 31, 2020. Prior to the Company's adoption of CECL on January 1, 2020, the allowance for credit losses related to AFS was not applicable and is therefore presented as \$0 at December 31, 2019. See Note 2.

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NOTES TO THE FINANCIAL STATEMENTS

December 31, 2020 and 2019

NOTE 3: DEBT SECURITIES - AVAILABLE-FOR-SALE (continued)

| (\$ in thousands) | Amortized cost | Gross unrealized gains | Gross unrealized losses | Fair value |
|--|---------------------|------------------------------|-------------------------------|---------------------|
| December 31, 2019: | | | | |
| Securities of U.S. Treasury and federal agencies | \$ 9,941 | \$ 340 | \$ - | \$ 10,281 |
| Federal agency mortgage-backed securities | 502,080 | 6,335 | (3) | 508,412 |
| Commercial mortgage-backed securities | 84,220 | - | (180) | 84,040 |
| Collateralized debt obligations | 1,109,207 | 1,170 | (3,759) | 1,106,618 |
| Corporate debt securities | 573,043 | 28,239 | (5) | 601,277 |
| Other debt securities | 16,840 | 246 | (132) | 16,954 |
| Total debt securities | \$ 2,295,331 | \$ 36,330 | \$ (4,079) | \$ 2,327,582 |

Gross Unrealized Losses and Fair Value

The following table shows the gross unrealized losses and fair value of securities in the available-for-sale securities portfolio by length of time that individual securities in each category had been in a continuous loss position. Debt securities on which the Company has recorded credit impairment are categorized as being “less than 12 months” or “12 months or more” in a continuous loss position based on the point in time that the fair value declined to below the (1) for the current period presented, amortized cost basis net of allowance for credit losses, or the (2) for the prior period presented, amortized cost basis.

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NOTES TO THE FINANCIAL STATEMENTS

December 31, 2020 and 2019

NOTE 3: DEBT SECURITIES - AVAILABLE-FOR-SALE (continued)

| | Less than 12 months | | 12 months or more | | Total | |
|--|-------------------------------|-------------------|-------------------------------|-------------------|-------------------------------|-------------------|
| | Gross unrealized losses | Fair value | Gross unrealized losses | Fair value | Gross unrealized losses | Fair value |
| (\$ in thousands) | | | | | | |
| December 31, 2020: | | | | | | |
| Securities of U.S. Treasury and federal agencies | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - |
| Federal agency mortgage-backed securities | - | - | - | - | - | - |
| Commercial mortgage-backed securities | - | - | (994) | 47,194 | (994) | 47,194 |
| Collateralized debt obligations | (1,491) | 343,524 | (1,927) | 329,834 | (3,418) | 673,358 |
| Corporate debt securities | (2,766) | 49,057 | (48) | 1,537 | (2,814) | 50,594 |
| Other debt securities | - | - | (11) | 7,435 | (11) | 7,435 |
| Total debt securities | \$ (4,257) | \$ 392,581 | \$ (2,980) | \$ 386,000 | \$ (7,237) | \$ 778,581 |
| December 31, 2019: | | | | | | |
| Securities of U.S. Treasury and federal agencies | \$ - | \$ - | \$ - | \$ - | \$ - | \$ - |
| Federal agency mortgage-backed securities | - | - | (3) | 550 | (3) | 550 |
| Commercial mortgage-backed securities | (180) | 84,040 | - | - | (180) | 84,040 |
| Collateralized debt obligations | (157) | 159,267 | (3,602) | 600,302 | (3,759) | 759,569 |
| Corporate debt securities | (5) | 5,173 | - | - | (5) | 5,173 |
| Other debt securities | (132) | 8,080 | - | - | (132) | 8,080 |
| Total debt securities | \$ (474) | \$ 256,560 | \$ (3,605) | \$ 600,852 | \$ (4,079) | \$ 857,412 |

The Company has assessed each debt security with gross unrealized losses included in the previous table for credit impairment. As part of that assessment the Company has evaluated and concluded that the Company does not intend to sell any of the debt securities, and that it is more likely than not that the Company will not be required to sell, prior to recovery of the amortized cost basis. The Company evaluates, where necessary, whether credit impairment exists by comparing the present value of the expected cash flows to the debt securities' amortized cost basis. In prior periods, credit impairment was recorded as a write-down to the amortized cost basis of the security. In the current period, credit impairment is recorded as an ACL for debt securities. For descriptions of the factors the Company considers when analyzing debt securities for impairment as well as methodology and significant inputs used to measure credit losses, see Note 2.

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December 31, 2020 and 2019

NOTE 3: DEBT SECURITIES - AVAILABLE-FOR-SALE (continued)

The following table shows remaining weighted average life maturities of securities available-for-sale, at fair value at December 31, 2020 and 2019. Weighted average life is the weighted average number of years an investment is expected to remain outstanding, based on its expected cash flows reflecting the estimated date the issuer will call or extend the maturity of the instrument or otherwise reflecting an estimate of the timing of an instrument's cash flows whose timing is not contractually fixed.

| (\$ in thousands) | Less than one year | One year to five years | Five years to ten years | More than ten years | Total |
|--|-----------------------|---------------------------|----------------------------|------------------------|---------------------|
| December 31, 2020: | | | | | |
| Securities of U.S. Treasury and federal agencies | \$ 404,946 | | 11,053 | | \$ 415,999 |
| Collateralized debt obligations | 14,762 | 557,605 | 283,530 | | 855,897 |
| Corporate debt securities | 3,846 | 205,861 | 231,599 | 75,465 | 516,771 |
| Other debt securities | | 7,435 | | 8,147 | 15,582 |
| Total non-mortgage backed securities | \$ 423,554 | \$ 770,901 | \$ 526,182 | \$ 83,612 | \$ 1,804,249 |
| Federal agency mortgage-backed securities | | | | | 350,783 |
| Commercial mortgage-backed securities | | | | | 47,194 |
| Total mortgage backed securities | | | | | \$ 397,977 |
| Total debt securities | | | | | \$ 2,202,226 |

December 31, 2019:

| | | | | | |
|--|-------------------|-------------------|-------------------|------------------|---------------------|
| Securities of U.S. Treasury and federal agencies | \$ - | \$ - | \$ 10,281 | \$ - | \$ 10,281 |
| Collateralized debt obligations | 110,541 | 712,450 | 283,627 | - | 1,106,618 |
| Corporate debt securities | 77,011 | 237,375 | 212,428 | 74,463 | 601,277 |
| Other debt securities | - | 8,080 | - | 8,874 | 16,954 |
| Total non-mortgage backed securities | \$ 187,552 | \$ 957,905 | \$ 506,336 | \$ 83,337 | \$ 1,735,130 |
| Federal agency mortgage-backed securities | | | | | 508,412 |
| Commercial mortgage-backed securities | | | | | 84,040 |
| Total mortgage backed securities | | | | | \$ 592,452 |
| Total debt securities | | | | | \$ 2,327,582 |

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NOTES TO THE FINANCIAL STATEMENTS

December 31, 2020 and 2019

NOTE 3: DEBT SECURITIES - AVAILABLE-FOR-SALE (continued)

Realized Gains and Losses

The following table shows the gross realized gains and losses on sales and OTTI write-downs related to the available-for-sale securities portfolio for the years ended December 31, 2020 and 2019. The Company has reviewed these securities in accordance with its accounting policy for OTTI, which is discussed in Note 2.

| (\$ in thousands) | 2020 | 2019 |
|--|----------------|------|
| Provision for credit losses (1): | | |
| Available-for-sale | \$ (1,831) | \$ - |
| Total provision for credit losses | (1,831) | - |
| Realized gains and losses: | | |
| Gross realized gains | 16 | - |
| Gross realized losses | (309) | - |
| OTTI write-downs (2) | - | - |
| Net realized gain from securities available-for-sale | \$ (293) | \$ - |

- (1) Prior to our adoption of CECL on January 1, 2020, the provision for credit losses from debt securities was not applicable and is therefore presented as \$0 for prior periods. See Note 2.
- (2) For the year ended December 31, 2020, credit-related impairment recognized in earnings is classified as provision for credit losses due to our adoption of CECL on January 1, 2020. See Note 2.

Pursuant to the reinsurance agreements between the Company and the direct insurers, the Company is required to maintain trust accounts to protect the interests of such direct insurers. At December 31, 2020, the Company held cash and cash equivalents and investment securities in individual trust accounts in the amount of \$1,879,470,155 which consisted of an amortized cost of \$140,660,525 in cash and cash equivalents and \$1,738,809,630 in securities available-for-sale.

At December 31, 2019, the Company held cash and cash equivalents and investment securities in individual trust accounts in the amount of \$1,987,156,628 which consisted of an amortized cost of \$231,596,343 in cash and cash equivalents and \$1,755,560,285 in securities available-for-sale.

NOTE 4: AFFILIATED PARTY TRANSACTIONS

Due to the nature of common ownership of the Company and its affiliated parties, the following transactions could differ from those conducted with unaffiliated parties.

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December 31, 2020 and 2019

NOTE 4: AFFILIATED PARTY TRANSACTIONS (continued)

The Company enters into borrowing and lending agreements with Well Fargo's primary funding affiliate as a way to efficiently manage its funding needs and excess cash flows. These arrangements are standard-form arrangements used by other Wells Fargo affiliates and the form, amounts and terms are reviewed and underwritten annually by independent credit areas. In June 2017, the Company entered into a borrowing agreement with WFC Holding, LLC. Terms of this agreement allowed the Company to borrow up to \$2,000,000,000. The basis for the interest rate was actual/365 using a one-calendar-month average of 3-month LIBOR plus 44.8 basis points. This agreement was updated in April 2019 allowing the Company to borrow up to \$1,500,000,000. The basis for the interest rate on the new agreement is actual/365 using a one-calendar-month average of 3-month LIBOR plus 61 basis points. This agreement was updated in November 2020 with the all terms remaining the same except terms allowing for the transition to an interest rate different than LIBOR. Intercompany debt to Parent was \$0 at both December 31, 2020 and December 31, 2019. The statements of income for 2020 and 2019 included \$0 and \$580,526, respectively, in interest expense associated with this note.

In April 2019, the Company entered into a lending agreement with WFC Holding, LLC. Terms of this agreement allow WFC, Holding LLC to borrow up to \$305,000,000. This agreement was amended in October 2019 allowing WFC, Holding LLC to borrow up to \$600,000,000 and again in July 2020 allowing WFC, Holding LLC to borrow up to \$900,000,000.

At December 31, 2020, the inter-company note receivable was \$84,147,019. The basis for the interest rate was actual/365 using a one-calendar-month average of 3-month LIBOR plus 64 basis points or 0.087%. Interest income associated with this note in 2020 was \$6,740,312. Additionally, the Company was owed interest of \$538,450 at December 31, 2020 in connection with this note.

At December 31, 2019, the inter-company note receivable was \$294,132,252. The basis for the interest rate was actual/365 using a one-calendar-month average of 3-month LIBOR plus 64 basis points or 2.55%. Interest income associated with this note in 2019 was \$3,168,432. Additionally, the Company was owed interest of \$692,266 at December 31, 2019 in connection with this note.

The Company regularly places trades for equity options and interest rate swaps with the Wholesale division (Wholesale) of Wells Fargo. The trades are priced in accordance with standard industry practices. The Company holds cash collateral in support of these trading positions, recorded in affiliate payable on the balance sheets of \$25,240,000 and \$25,560,000 as of December 31, 2020 and 2019, respectively. It is the Company's policy to present derivative balances and related cash collateral amounts net on the balance sheet when the master netting arrangements meet the applicable requirements. See Note 2. The Company pays interest on the outstanding balance at the end of every month based on the Fed Funds rate (0.09% as of December 31, 2020 and 1.55% as of December 31, 2019). The Company recognized interest income \$5,365 and \$0 and incurred interest expense of (\$20,739) and \$14,850 in 2020 and 2019, respectively.

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NOTES TO THE FINANCIAL STATEMENTS

December 31, 2020 and 2019

NOTE 4: AFFILIATED PARTY TRANSACTIONS (continued)

The Company uses Wells Fargo Securities (WFS), which is a subdivision of Wholesale, for its equity futures transactions. WFS acts as a broker for these transactions, however, the margin balance is recorded in affiliate receivable on the balance sheets. The balance as of December 31, 2020 and 2019 is \$2,132,829 and \$2,697,434, respectively. The affiliate receivable also includes outstanding transactions with Wholesale related to the equity options and interest rate swaps. As of December 31, 2020 and 2019, there were no outstanding transactions.

The Company purchases derivatives to manage exposure to market risk, including interest rate risk and credit risk. The counterparties on these derivatives are affiliates of the Company. The Company has entered into agreements that allow netting of derivative asset and liability balances, including related cash collateral adjustments. For more information on these transactions, see Note 7.

The Company is subject to pay affiliated entities for services provided to it. In 2019 the Company paid Wells Fargo Bank, N.A. (WFB) \$250,000, which is included in affiliate expense in the statement of income. The Company also pays Wells Fargo Treasury (Treasury) management fees related to the operating bank account. In 2020 and 2019 the Company paid Treasury \$4,654 and \$4,059, respectively, which is included in affiliate expense in the statements of income.

The Company has a service level agreement with Wells Fargo Wealth Brokerage Insurance Agency, LLC (WFWBIA), Wells Fargo Bank N.A. (WFB), and starting in April 2017, Wells Fargo Insurance, Inc. (WFII). Under this agreement, the Company is obligated to pay WFWBIA, WFB, and WFII for direct expenses, primarily personnel and outside professional service expenses, and indirect expenses, primarily allocated corporate support function expenses. For the years ended December 31, 2020 and 2019, \$8,470,592 and \$9,576,725, respectively, were included in affiliate expense in the statements of income related to this agreement. The Company has no employees.

The Company is charged under an expense sharing arrangement fees or expense allocations by various affiliate service providers which represent reimbursement for direct cost and general overhead costs incurred by the affiliate for support services to the Company. Services under these arrangements include information technology systems, support and development; operations support; and general and administrative support services. Allocation methodologies are customized by the type of product line being supported. Fees charged were \$3,364,542 and \$7,196,243 respectively, for the year ended December 31, 2020 and 2019.

The Company may, from time to time, purchase or sell securities from / to affiliates under market prices at arms-length terms. This occurs when the objectives of two Wells Fargo affiliates can be met through an internal sale without creating any adverse outcome for either affiliate. This could include scenarios where one affiliate may need to sell securities to pay for a dividend, but the quality of the securities is attractive and the Company has the ability to purchase those securities.

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NOTES TO THE FINANCIAL STATEMENTS

December 31, 2020 and 2019

NOTE 5: REINSURANCE

SURPLUS RELIEF AGREEMENTS

The Company enters into surplus relief reinsurance transactions with U.S. domiciled direct underwriting and reinsurance carriers. The types of business assumed generally consist of level premium term and yearly renewable term life insurance. Since the Company is not a U.S. authorized reinsurance carrier, the Company must provide collateral for reserve credits taken by the ceding companies by placing assets in trust accounts. The Company continues to own and consolidate its share of the trusts' invested assets on the accompanying balance sheets and recognizes gains or losses on the assets. As a result of providing the collateral needed to support the reserve credit, the Company earned reinsurance fee income of \$16,520,866 and \$18,622,517 in 2020 and 2019, respectively.

Commitments and assets held in trust under the surplus relief deals outstanding at December 31, 2020 and 2019 are presented in the table below.

| (\$ in thousands) | 2020 | 2019 |
|--|--------------|--------------|
| Maximum potential reserve credit | \$ 1,665,000 | \$ 1,850,000 |
| Outstanding reserve credit | 1,270,742 | 1,532,393 |
| Associated assets held in trust (amortized cost) | 1,317,710 | 1,603,359 |

Two reinsurance contracts were recaptured and therefore the Company did not have any outstanding insurance liabilities related to these contracts. However, the Company still had assets held in the trusts related to these contracts due to the timing of the recapture. The assets held in trusts related to these contracts are presented below.

| (\$ in thousands) | 2020 |
|---|---------------|
| For the year ended December 31 | |
| Associated assets held in trust (cash and cash equivalents, amortized cost) | \$ 8,531 |
| Associated assets held in trust (investment securities, amortized cost) | 54,236 |
| | 62,767 |

In 2013, the Company entered into stop loss reinsurance contracts which are a subset of the surplus relief product. Stop loss reinsurance is based on an attachment point that is generally higher than that of a typical surplus relief structure. Due to the higher attachment point, the Company is required to place fewer assets in trust or none at all. The Company earned reinsurance fee income of \$32,123,985 and \$40,786,333 in 2020 and 2019, respectively.

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NOTES TO THE FINANCIAL STATEMENTS

December 31, 2020 and 2019

NOTE 5: REINSURANCE (continued)

Commitments and assets held in trust under the stop loss contracts outstanding at December 31, 2020 and 2019 are presented in the table below.

| (\$ in thousands) | 2020 | 2019 |
|--|--------------|--------------|
| Maximum potential reserve credit | \$ 7,100,000 | \$ 8,830,675 |
| Outstanding reserve credit | 5,719,405 | 7,920,360 |
| Associated assets held in trust (amortized cost) | — | 234 |

The reserve credit for certain contracts are in Eurodollars. The table above reflects appropriate conversion to U.S. dollars as of December 31, 2020 and 2019.

VARIABLE ANNUITY AGREEMENTS

The Company enters into reinsurance contracts with direct underwriters for new business production of variable annuity products. The transactions are coinsurance and modified coinsurance agreements. Certain contracts offer various guaranteed minimum death, withdrawal, income and accumulation benefits. Those benefits are accounted for as derivatives under FASB ASC 815 or as insurance contracts depending on the terms of underlying policies, as discussed below.

Guaranteed minimum benefits often meet the definition of an embedded derivative; however, certain guaranteed minimum benefits settle only upon a single insurable event, such as death (guaranteed minimum death benefits (GMDB)) or living (life contingent portion of guaranteed minimum withdrawal benefits (GMWB)) and as such are accounted for as insurance contracts. For such contracts, the statements of income reflect the current period increase in the liability due to the deferral of a percentage of current period revenues. Claims recorded against the liability have no immediate impact on the statements of income unless those claims exceed the liability. Periodically, the Company unlocks its benefit assumptions, including the benefit deferral rate. The impact of this change is reflected in the change in liability for future policy benefits in the statements of income. The liability related to these benefits was \$554,944,036 and \$462,218,765 at December 31, 2020 and 2019, respectively, and is included in liability for future policy benefits on the balance sheets.

The Company's guaranteed minimum accumulation benefits, the portion that is not life contingent for GMWB, and the guaranteed minimum income benefits that are embedded derivatives are recorded at fair value with changes in fair value recorded in net gain (loss) on embedded derivatives in the statements of income. The embedded derivative liability balance was \$26,517,062 and \$17,200,235 at December 31, 2020 and 2019, respectively, and is included in embedded derivative liabilities on the balance sheets.

Changes in capital markets or policyholder behavior may increase or decrease the Company's exposure to benefits under the guarantees. As a result, the Company uses derivative instruments, included in trading account assets and liabilities on the balance sheets, to mitigate portions of that exposure. See Note 7 for more information on these derivatives.

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NOTES TO THE FINANCIAL STATEMENTS

December 31, 2020 and 2019

NOTE 5: REINSURANCE (continued)

The Company earned reinsurance premiums of \$194,221,761 and \$198,622,203 in 2020 and 2019, included in net reinsurance premiums earned in the statements of income.

NOTE 6: VALUE OF BUSINESS ACQUIRED / DEFERRED ACQUISITION COSTS

Acquisition costs deferred and amortized in 2020 and 2019 are presented in the table below.

| (\$ in thousands) | | DAC Amount | VOBA Amount |
|--|----|---------------|------------------|
| Deferred acquisition costs / value of business acquired, December 31, 2018 | \$ | 9,462 | \$ 26,755 |
| Amortized costs | | (1,044) | (3,541) |
| Deferred acquisition costs / value of business acquired, December 31, 2019 | \$ | 8,418 | \$ 23,214 |
| Amortized costs | | (985) | (3,207) |
| Deferred acquisition costs / value of business acquired, December 31, 2020 | \$ | 7,433 | \$ 20,007 |

The outstanding VOBA and DAC are entirely attributable to variable annuity treaties. The VOBA and DAC are expected to be amortized as shown in the table below.

| (\$ in thousands) | DAC Amortization | VOBA Amortization |
|-----------------------------|---------------------|----------------------|
| 2021 | 917 | 2,843 |
| 2022 | 876 | 2,580 |
| 2023 | 1,054 | 2,964 |
| 2024 | 1,085 | 2,940 |
| 2025 | 946 | 2,433 |
| Greater than 5 years | 2,555 | 6,247 |

NOTE 7: DERIVATIVES

The Company uses derivatives to manage exposure to market risk, including interest rate risk and credit risk. The Company designates certain derivatives as hedging instruments in a qualifying hedge accounting relationship (fair value hedges). The remaining derivatives consist of economic hedges that do not qualify for hedge accounting.

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NOTES TO THE FINANCIAL STATEMENTS

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NOTE 7: DERIVATIVES (continued)

The Company's asset/liability management approach to interest rate and certain other risks includes the use of derivatives. Such derivatives are typically designated as fair value hedges, or economic hedges. The Company uses derivatives to help minimize significant, unplanned fluctuations in earnings, fair values of assets and liabilities, and other market risk volatility. This approach involves modifying the repricing characteristics of certain assets and liabilities so that changes in interest rates and other exposures, which may cause the hedged assets and liabilities to gain or lose fair value, do not have a significantly adverse effect on the net interest margin and earnings. In a fair value or economic hedge, the effect of change in fair value will generally be offset by the unrealized gain or loss on the derivatives linked to the hedged assets and liabilities.

Embedded derivatives that are required to be accounted for separately from their host contracts are included in other derivatives disclosures as applicable.

The table below presents the total notional or contractual amounts and fair values for the Company's derivatives. Derivative transactions can be measured in terms of the notional amount, but this amount is not recorded on the balance sheet and is not, when viewed in isolation, a meaningful measure of the risk profile of the instruments. The notional amount is generally not exchanged, but is used only as the basis on which interest and other payments are determined.

| December 31, 2020 (\$ in thousands) | Notional Amount | Assets | Liabilities |
|--|--------------------|-----------|-------------|
| Derivatives designated as hedging instruments | | | |
| Interest rate swaps | \$ 443,259 | \$ 210 | \$ 40,665 |
| Total derivatives designated as hedging instruments | | 210 | 40,665 |
| Derivatives not designated as hedging instruments | | | |
| Economic hedges: | | | |
| Equity options | 264,464 | 20,755 | - |
| Interest rate swaps | 866,600 | 82,298 | 37,360 |
| Equity futures | 73,188 | - | - |
| Total derivatives not designated as hedging instruments | - | 103,053 | 37,360 |
| Embedded derivative | - | - | 26,517 |
| Total derivatives before netting | | 103,263 | 104,542 |
| Netting (1) | | (103,263) | (78,025) |
| Total derivatives | \$ | - | \$ 26,517 |

(1) Represents balance sheet netting of derivative asset and liability balances and related cash collateral. See the next table in this note for further information.

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December 31, 2020 and 2019

NOTE 7: DERIVATIVES (continued)

| December 31, 2019 (\$ in thousands) | Notional Amount | Assets | Liabilities |
|---|--------------------|----------|-------------|
| Derivatives designated as hedging instruments | | | |
| Interest rate swaps | \$ 533,976 | \$ 4 | \$ 24,171 |
| Total derivatives designated as hedging instruments | | 4 | 24,171 |
| Derivatives not designated as hedging instruments | | | |
| Economic hedges: | | | |
| Equity options | 302,064 | 12,924 | - |
| Interest rate swaps | 877,700 | 53,423 | 16,846 |
| Equity futures | 70,628 | - | - |
| Total derivatives not designated as hedging instruments | - | 66,347 | 16,846 |
| Embedded derivative | - | - | 17,200 |
| Total derivatives before netting | | 66,351 | 58,217 |
| Netting (1) | | (66,351) | (41,017) |
| Total derivatives | \$ | - | \$ 17,200 |

(1) Represents balance sheet netting of derivative asset and liability balances and related cash collateral. See the next table in this note for further information.

The next table provides information on the gross fair values of derivative assets and liabilities, the balance sheet netting adjustments and the resulting net fair value amount recorded on the balance sheet, as well as the non-cash collateral associated with such arrangements. The Company executes all derivative transactions under master netting arrangements and reflect all derivative balances and related cash collateral subject to enforceable master netting arrangements on a net basis within the balance sheet. The “Gross amounts recognized” column in the following table includes \$103,263,299 and \$104,541,481 of gross derivative assets and liabilities, respectively, at December 31, 2020 and, \$66,350,991 and \$58,216,990 of gross derivative assets and liabilities, respectively, at December 31, 2019, with counterparties subject to enforceable master netting arrangements that are carried on the balance sheet net of offsetting amounts.

The Company determines the balance sheet netting adjustments based on the terms specified within each master netting arrangement. The Company discloses the balance sheet netting amounts within the column titled “Gross amounts offset in balance sheet” in the table below. Balance sheet netting adjustments are determined at the counterparty level for which there may be multiple contract types. For disclosure purposes, the Company allocates these netting adjustments to the contract type for each counterparty proportionally based upon the “Gross amounts recognized” by counterparty. As a result, the net amounts disclosed by contract type may not represent the actual exposure upon settlement of the contracts.

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December 31, 2020 and 2019

NOTE 7: DERIVATIVES (continued)

The Company manages derivative exposure by monitoring the credit risk associated with each counterparty using counterparty specific credit risk limits, using master netting arrangements and obtaining collateral. Derivative contracts executed in over-the-counter markets include bilateral contractual arrangements that are not cleared through a central clearing organization but are typically subject to master netting arrangements. The percentage of our bilateral derivative transactions outstanding at period end in such markets, based on gross fair value, is provided within the following table. Other derivative contracts executed in over-the-counter or exchange-traded markets are settled through a central clearing organization and are excluded from this percentage.

| (\$ in thousands) | Gross amounts recognized | Gross amounts offset in balance sheet (1) | Net amounts in balance sheet |
|-------------------------------------|-----------------------------|---|------------------------------------|
| December 31, 2020 | | | |
| Derivative assets | | | |
| Interest rate swaps | \$ 82,508 | \$ (82,508) | \$ - |
| Equity options | 20,755 | (20,755) | - |
| Total derivative assets | 103,263 | (103,263) | - |
| Derivative liabilities | | | |
| Interest rate swaps | 78,025 | (78,025) | - |
| Embedded derivative | 26,517 | | 26,517 |
| Total derivative liabilities | \$ 104,542 | \$ (78,025) | \$ 26,517 |

(1) Represents amounts with counterparties subject to enforceable master netting arrangements that have been offset on the balance sheet, including related cash collateral of \$25,239.

| (\$ in thousands) | Gross amounts recognized | Gross amounts offset in balance sheet (1) | Net amounts in balance sheet |
|-------------------------------------|-----------------------------|---|------------------------------------|
| December 31, 2019 | | | |
| Derivative assets | | | |
| Interest rate swaps | \$ 53,427 | \$ (53,427) | \$ - |
| Equity options | 12,924 | (12,924) | - |
| Total derivative assets | 66,351 | (66,351) | - |
| Derivative liabilities | | | |
| Interest rate swaps | 41,017 | (41,017) | - |
| Embedded derivative | 17,200 | - | 17,200 |
| Total derivative liabilities | \$ 58,217 | \$ (41,017) | \$ 17,200 |

(1) Represents amounts with counterparties subject to enforceable master netting arrangements that have been offset on the balance sheet, including related cash collateral of \$25,334.

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NOTES TO THE FINANCIAL STATEMENTS

December 31, 2020 and 2019

NOTE 7: DERIVATIVES (continued)

Fair Value Hedges

The Company uses interest rate swaps to convert certain of our fixed-rate long-term debt to floating rates to hedge our exposure to interest rate risk. In addition, the Company uses interest rate swaps to hedge against changes in fair value of certain investments in available-for-sale debt securities due to changes in interest rates.

The table below shows the net gains (losses) recognized in the statements of income related to derivatives in fair value hedging relationships.

| (\$ in thousands) | 2020 | 2019 |
|--|------------|------------|
| Total amounts presented in the statement of income | \$ 49,325 | \$ 95,162 |
| Gains (losses) on fair value hedging relationships | | |
| Interest Contracts | | |
| Amounts related to interest settlements on derivatives | (8,467) | (1,713) |
| Recognized on derivatives | (18,899) | (19,166) |
| Recognized on hedged items | 18,694 | 19,085 |
| Net expense recognized on fair value hedges | \$ (8,672) | \$ (1,794) |

(Continued)

UNION HAMILTON REINSURANCE, LTD.
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NOTES TO THE FINANCIAL STATEMENTS

December 31, 2020 and 2019

NOTE 7: DERIVATIVES (continued)

The table below shows the carrying amount and associated cumulative basis adjustment related to the application of hedge accounting that is included in the carrying amount of hedged assets and liabilities in fair value hedging relationships.

| (\$ in thousands) | Hedged items currently designated | | Hedged items no longer designated (1) | |
|---|-----------------------------------|--|---------------------------------------|--|
| | Carrying amount of assets (3) | Hedge accounting basis adjustment assets(liabilities) (2) | Carrying amount of assets (3) | Hedge accounting basis adjustment assets(liabilities) (2) |
| December 31, 2020 | | | | |
| Investments securities, Available-for sale (4) | \$ 439,659 | \$ 28,281 | \$ 23,256 | \$ 170 |

- (1) Represents hedged items no longer designated in qualifying fair value hedging relationships for which an associated basis adjustment exists at the balance sheet date.
- (2) The balance includes \$7,813 of investment securities cumulative basis adjustments on terminated hedges whereby the hedged items have subsequently been re-designated into existing hedges.
- (3) Represents the full carrying amount of the hedged asset item as of the balance sheet date, except for circumstances in which only a portion of the asset was designated at the hedged item in which case only the portion designated is presented.
- (4) Carrying amount represents the amortized cost.

| (\$ in thousands) | Hedged items currently designated | | Hedged items no longer designated (1) | |
|--|-----------------------------------|--|---------------------------------------|--|
| | Carrying amount of assets (3) | Hedge accounting basis adjustment assets(liabilities) (2) | Carrying amount of assets (3) | Hedge accounting basis adjustment assets(liabilities) (2) |
| December 31, 2019 | | | | |
| Investments securities, Available-for sale (4) | \$ 504,619 | \$ 32,371 | \$ 21,258 | \$ 153 |

- (1) Represents hedged items no longer designated in qualifying fair value hedging relationships for which an associated basis adjustment exists at the balance sheet date.
- (2) The balance includes \$12,238 of investment securities cumulative basis adjustments on terminated hedges whereby the hedged items have subsequently been re-designated into existing hedges.
- (3) Represents the full carrying amount of the hedged asset item as of the balance sheet date, except for circumstances in which only a portion of the asset was designated at the hedged item in which case only the portion designated is presented.
- (4) Carrying amount represents the amortized cost.

The embedded derivatives primarily relate to the Company's reinsurance of variable annuity contracts with guaranteed minimum benefits as described in Note 5. Embedded derivative losses of \$9,373,002 and gains of \$11,807,524 were reported for 2020 and 2019, respectively. Trading derivative gains of \$2,534,076 and losses of \$15,866,984 were reported for 2020 and 2019, respectively.

The Company maintains a margin account to support certain activities in the trading accounts above. In 2020 and 2019 the broker was Wells Fargo Securities. A U.S. Treasury Note with a fair value of \$11,053,516 and \$10,280,859, (included in investment securities on the balance sheet) and a cash deposit of \$2,132,829 and \$2,697,434 (included in affiliate receivables on the balance sheets) are held by the broker at December 31, 2020 and 2019, respectively, for the benefit of the Company.

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NOTES TO THE FINANCIAL STATEMENTS

December 31, 2020 and 2019

NOTE 8: FAIR VALUES OF ASSETS AND LIABILITIES

The Company uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. Securities available for sale and derivatives are recorded at fair value on a recurring basis.

FAIR VALUE HIERARCHY

The Company groups assets and liabilities measured at fair value in three levels based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value.

These levels are:

- Level 1 – Valuation is based upon quoted prices for identical instruments traded in active markets.
- Level 2 – Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.
- Level 3 – Valuation is generated from techniques that use significant assumptions that are not observable in the market. These unobservable assumptions reflect estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include use of option pricing models, discounted cash flow models and similar techniques.

In the determination of the classification of financial instruments in Level 2 or Level 3 of the fair value hierarchy, the Company considers all available information, including observable market data, indications of market liquidity and orderliness, and its understanding of the valuation techniques and significant inputs used. Otherwise, the classification of Level 2 or Level 3 is based upon the specific facts and circumstances of each instrument or instrument category and judgments are made regarding the significance of the Level 3 inputs to the instruments' fair value measurement in its entirety. If Level 3 inputs are considered significant, the instrument is classified as Level 3.

AVAILABLE-FOR-SALE SECURITIES

AFS debt securities are recorded at fair value on a recurring basis. Fair value measurement for AFS debt securities is based upon various sources of market pricing. Where available, the Company uses quoted prices in active markets. When instruments are traded in secondary markets and quoted prices in active markets do not exist for such securities, the Company uses prices obtained from third-party pricing services and, to a lesser extent, may use prices obtained from independent broker-dealers (brokers), collectively vendor prices. Substantially all of our AFS debt securities are recorded using vendor prices. When vendor prices are deemed inappropriate, they may be adjusted based on other market data or internal models. The Company also uses internal models when no vendor prices are available. Internal models use discounted cash flow techniques or market comparable pricing techniques

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NOTES TO THE FINANCIAL STATEMENTS

December 31, 2020 and 2019

NOTE 8: FAIR VALUES OF ASSETS AND LIABILITIES (continued)

Available-for-sale securities are recorded at fair value on a recurring basis. Fair value measurement is based upon various sources of market pricing. The Company uses quoted prices in active markets, where available, and classify such instruments within Level 1 of the fair value hierarchy. Examples include some highly liquid government securities, such as U.S. Treasuries. When instruments are traded in secondary markets and quoted market prices do not exist for such securities, the Company generally relies on internal valuation techniques or on prices obtained from vendors (predominantly third-party pricing services), and accordingly, the Company classifies these instruments as Level 2 or 3.

DERIVATIVES

Derivatives are recorded at fair value on a recurring basis. The fair value of substantially all exchange-traded derivatives, which include certain equity option contracts, are measured using available quoted market prices. The fair value of non-exchange-traded derivatives, which predominantly relate to derivatives traded in over-the-counter (OTC) markets, are measured using internal valuation techniques, as quoted market prices are not always readily available. Valuation techniques and inputs to internally developed models depend on the type of derivative and nature of the underlying rate, price or index upon which the value of the derivative is based. Key inputs can include yield curves, credit curves, foreign exchange rates, prepayment rates, volatility measurements and correlation of certain of these inputs.

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NOTES TO THE FINANCIAL STATEMENTS

December 31, 2020 and 2019

NOTE 8: FAIR VALUES OF ASSETS AND LIABILITIES (continued)

ASSETS AND LIABILITIES RECORDED AT FAIR VALUE ON A RECURRING BASIS

The following table presents the Company's assets and liabilities that are measured at fair value on a recurring basis at December 31, 2020 and 2019, for each of the fair value hierarchy levels.

(\$ in thousands)

| December 31, 2020 | Level 1 | Level 2 | Level 3 | Total |
|--|-------------------|---------------------|------------------|---------------------|
| Assets | | | | |
| Securities of U.S. Treasury and federal agencies | \$ 415,999 | \$ - | \$ - | \$ 415,999 |
| Federal agency mortgage-backed securities | - | 350,783 | - | 350,783 |
| Commercial mortgage-backed securities | - | 47,194 | - | 47,194 |
| Collateralized debt obligations | - | 855,897 | - | 855,897 |
| Corporate debt securities | - | 516,771 | - | 516,771 |
| Other debt securities | - | 15,582 | - | 15,582 |
| Total debt securities | 415,999 | 1,786,227 | - | 2,202,226 |
| Equity options | - | 20,755 | - | 20,755 |
| Interest rate swaps | - | 82,508 | - | 82,508 |
| Total derivative assets | - | 103,263 | - | 103,263 |
| Total assets | \$ 415,999 | \$ 1,889,490 | \$ - | \$ 2,305,489 |
| Liabilities | | | | |
| Interest rate swaps | \$ - | \$ 78,025 | \$ - | \$ 78,025 |
| Total derivative liabilities | - | 78,025 | - | 78,025 |
| Embedded derivative liabilities | - | - | 26,517 | 26,517 |
| Total liabilities | \$ - | \$ 78,025 | \$ 26,517 | \$ 104,542 |

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NOTES TO THE FINANCIAL STATEMENTS

December 31, 2020 and 2019

NOTE 8: FAIR VALUES OF ASSETS AND LIABILITIES (continued)

(\$ in thousands)

| December 31, 2019 | Level 1 | Level 2 | Level 3 | Total |
|--|-----------|--------------|-----------|--------------|
| Assets | | | | |
| Securities of U.S. Treasury and federal agencies | \$ 10,281 | \$ - | \$ - | \$ 10,281 |
| Federal agency mortgage-backed securities | - | 508,412 | - | 508,412 |
| Commercial mortgage-backed securities | - | 84,040 | - | 84,040 |
| Collateralized debt obligations | - | 1,106,618 | - | 1,106,618 |
| Corporate debt securities | - | 601,277 | - | 601,277 |
| Other debt securities | - | 16,954 | - | 16,954 |
| Total debt securities | 10,281 | 2,317,301 | - | 2,327,582 |
| Equity options | - | 12,924 | - | 12,924 |
| Interest rate swaps | - | 53,427 | - | 53,427 |
| Total derivative assets | - | 66,351 | - | 66,351 |
| Total assets | \$ 10,281 | \$ 2,383,652 | \$ - | \$ 2,393,933 |
| Liabilities | | | | |
| Interest rate swaps | \$ - | \$ 41,017 | \$ - | \$ 41,017 |
| Total derivative liabilities | - | 41,017 | - | 41,017 |
| Embedded derivative liabilities | - | - | 17,200 | 17,200 |
| Total liabilities | \$ - | \$ 41,017 | \$ 17,200 | \$ 58,217 |

The Company's policy is to recognize transfers between levels of the fair value hierarchy on the date of the event or change in circumstances that caused the transfer. The Company monitors the availability of observable market data to assess the appropriate classification of financial instruments within the fair value hierarchy. Changes in economic conditions or model-based valuation techniques may require the transfer of financial instruments from one fair value level to another. There were no transfers into or out of Level 1, Level 2, or Level 3 for the years ended December 31, 2020 and 2019.

Material changes that affect the investment options available to policyholders related to annuity business being reinsured must be communicated by the direct underwriter. The Company may accept or reject any material changes. If the Company rejects any such change, the Company's liability will be determined as if no such change had occurred. However, if the liability is unable to be recalculated excluding any material changes, an alternative settlement can be agreed upon between the Company and the direct underwriter.

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UNION HAMILTON REINSURANCE, LTD.
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NOTES TO THE FINANCIAL STATEMENTS

December 31, 2020 and 2019

NOTE 8: FAIR VALUES OF ASSETS AND LIABILITIES (continued)

The changes in Level 3 liabilities measured at fair value on a recurring basis for the years ended December 31, 2020 and 2019 are summarized in the table below.

| (\$ in thousands) | Balance, beginning of period | Net income (loss) | Other comprehensive income | Sales | Material change settlement | Balance, end of period | Net unrealized gains (losses) included in income related to assets and liabilities held at period end |
|--|------------------------------------|-------------------------|----------------------------------|-------|----------------------------------|------------------------------|--|
| December 31, 2020 | | | | | | | |
| Embedded derivative liabilities | \$ (17,200) | \$ (9,373) | | | 56 | (26,517) | (9,373) |
| December 31, 2019 | | | | | | | |
| Embedded derivative liabilities | \$ (27,623) | \$ 11,808 | - | - | (1,385) | (17,200) | 11,808 |

The embedded derivatives from the variable annuity reinsurance contracts use unobservable inputs to derive the fair value. These inputs include volatility, interest rates, equity markets and actuarial assumptions such as mortality, lapses and other policyholder behavior.

As of December 31, 2020 and 2019, the Company did not have any assets or liabilities that were measured at fair value on a nonrecurring basis. Also, the Company did not elect the fair value option under Financial Instruments (FASB ASC 825).

OTHER

Other assets and liabilities such as receivables and payables are deemed to be a reasonable estimate of fair value due to the short-term nature of these instruments. Certain instruments such as deferred acquisition costs, deferred income taxes and liability for future policy benefits are excluded from the fair value disclosure, and accordingly, the fair value amounts cannot be aggregated to determine the underlying economic value of the Company. The carrying value of the intercompany notes approximates fair value due to its variable interest rate indexed on LIBOR.

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NOTES TO THE FINANCIAL STATEMENTS

December 31, 2020 and 2019

NOTE 9: INCOME TAX EXPENSE

BERMUDA

The Company has received an undertaking from the Minister of Finance in Bermuda that, in the event of any imposition of income taxes, the Company will be exempted from taxation until the year 2035.

UNITED STATES

The Company made an irrevocable election under Section 953(d) of the Internal Revenue Code of 1986, as amended, to treat the Company as a domestic insurance company for U.S. federal income tax purposes. As a result of the “domestic election”, the Company is subject to U.S. taxation on its worldwide income as if it were a U.S. corporation. Beginning in 2014, the Company was included in Wells Fargo’s federal consolidated income tax return, and is subject to the allocation of the tax liability (benefit) of the consolidated group. Deferred income tax assets and liabilities are established for the expected future tax consequences attributable to temporary differences between the financial statement carrying amount and the tax basis of assets and liabilities. Deferred income 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. The effect of a change in income tax rates on deferred income tax assets and liabilities is recognized in income during the period that includes the enactment date.

The aggregate amount of income tax expense (benefit) included in the statements of income and in the statements of comprehensive income for each of the years in the two-year period ended December 31, 2020 is presented below.

| (\$ in thousands) | 2020 | 2019 |
|---|-----------|-----------|
| STATEMENTS OF INCOME | | |
| Federal income tax expense | \$ 36,634 | \$ 49,179 |
| State income tax expense | 674 | - |
| STATEMENTS OF COMPREHENSIVE INCOME | | |
| Income tax (benefit) expense related to unrealized gains on debt securities | (24) | 9,902 |
| Total | \$ 37,284 | \$ 59,081 |

Income tax expense (benefit) for 2020 and 2019 is presented below.

| (\$ in thousands) | 2020 | 2019 |
|------------------------------------|-----------|------------|
| Current federal income tax expense | \$ 89,143 | \$ 101,663 |
| Current state income tax expense | 560 | - |
| Deferred income tax (benefit) | (52,509) | (52,484) |
| Deferred income tax expense | 114 | - |
| Total income tax expense (benefit) | \$ 37,308 | \$ 49,179 |

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NOTES TO THE FINANCIAL STATEMENTS

December 31, 2020 and 2019

NOTE 9: INCOME TAX EXPENSE (continued)

The tax effects of temporary differences that give rise to significant portions of deferred income tax assets and liabilities at December 31, 2020 and 2019 are presented in the table below.

| (\$ in thousands) | 2020 | 2019 |
|---|--------------------|-------------|
| DEFERRED INCOME TAX ASSETS | | |
| Loss reserve discounting | \$ 15,840 | \$ 24,500 |
| Other | 4,697 | 5,292 |
| Deferred income tax assets | 20,537 | 29,792 |
| DEFERRED INCOME TAX LIABILITIES | | |
| Unrealized gains on securities and foreign currency differences | 6,748 | 6,773 |
| Loss reserve tax reform transition adjustment | 3,639 | 4,366 |
| Insurance reserves | 49,080 | 110,133 |
| Other | 210 | 81 |
| Deferred income tax liabilities | 59,677 | 121,353 |
| Net deferred income tax liabilities | \$ (39,140) | \$ (91,561) |

A portion of the annual change in the net deferred income tax liability relates to unrealized gains and losses on debt securities available for sale. The securities related deferred income tax benefit of \$24,338 in 2020 and deferred income tax expense of \$9,902,572 in 2019 have been recorded in stockholder's equity as a component of accumulated other comprehensive income (loss). Net deferred tax balances as of December 31, 2020 include a \$384,569 impact as a result of the Company's adoption of ASU 2016-13 Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments.

Management believes that it is more likely than not that the deferred income tax assets will be realized. Based on the tax allocation method described above, the Company relies on the income of its parent in forecasting its ability to utilize deferred taxes. Parent's taxable income provides capacity to realize those deferred tax assets that would create net operating losses or capital losses recoverable in the consolidated return. Therefore, no valuation allowance is necessary for the separate deferred tax assets. Accordingly, there were no valuation allowances for deferred income tax assets at December 31, 2020 or 2019.

The Company evaluates uncertain tax positions in accordance with FASB ASC 740, *Income Taxes*. Based upon its current evaluation, the Company has recorded reserves for uncertain tax positions of \$0 and \$9,772,991 for the periods ending December 31, 2020 and December 31, 2019, respectively. In 2020, the Company resolved the issue with the IRS related to the uncertain tax position. As such, there is no longer a required reserve under ACS 740. At December 31, 2020 and December 31, 2019, respectively, management does not expect any material change in unrecognized income tax benefits within the next twelve months.

The Company recognizes accrued interest and penalties, as appropriate, related to unrecognized income tax benefits in the effective tax rate. The Company recognized no interest in 2020 and 2019 and the balance of accrued interest was \$0 at December 31, 2020 and 2019.

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NOTES TO THE FINANCIAL STATEMENTS

December 31, 2020 and 2019

NOTE 9: INCOME TAX EXPENSE (continued)

Management monitors proposed and issued tax law, regulations and cases to determine the potential impact to uncertain income tax positions. At December 31, 2020, management had not identified any potential subsequent events that would have a material impact on unrecognized income tax benefits within the next twelve months.

The Company is not subject to examinations by the Internal Revenue Service for years prior to 2015.

(\$ in thousands)

| Reconciliation to Statutory Rate: | 2020 | | 2019 | |
|---|------------------|-----------------------------|------------------|-----------------------------|
| | Amount | Percent of pretax income | Amount | Percent of pretax income |
| Net income before income tax expense | \$ 175,121 | | \$ 233,643 | |
| Tax expense at federal tax rate | 36,634 | 20.92% | 49,065 | 21.00% |
| State tax expense, net of federal tax expense | 674 | 0.38% | - | 0.00% |
| Change in deferred tax due to federal tax rate reduction effective January 1, 2018 | - | 0.00% | 114 | 0.05% |
| Total tax (benefit) expense | \$ 37,308 | 21.30% | \$ 49,179 | 21.05% |

NOTE 10: STATUTORY REQUIREMENTS

The Company is licensed as a Class E Long term insurer under the Bermuda Insurance Act 1978, amendments thereto and related Regulations (the "Act"). Under the Act, the Company is required to maintain capital and surplus greater than a minimum statutory amount determined as the greater of (i) the Minimum Solvency Margin (MSM) or (ii) the Enhanced Capital Requirement (ECR), both of which are calculated using the standard Bermuda Solvency Capital Requirement (BSCR) model and statutory accounting principles. At December 31, 2020, the greater of those was \$161,687,000. As part of the BSCR, the Company also calculates the Commercial Insurers Solvency Self-Assessment (CISSA) capital to refine the standard capital for the unique risks of the Company. At December 31, 2020, the Company's CISSA capital and surplus for its long-term business was \$57,840,000. Actual available statutory capital and surplus, as determined using the BSCR and Bermuda statutory accounting principles, at December 31, 2020 was \$1,865,755,000 and \$1,923,982,000, respectively.

Accordingly, since there is sufficient available statutory capital and surplus to satisfy ECR and MSM minimum requirements, there are no restrictions on dividends or return of statutory capital available for distribution, provided all applicable regulatory requirements are satisfied.