

# **Financial Statements**

## **Austral Resseguradora S.A.**

December 31, 2016 and 2015  
with Independent Auditor's Report

# **Austral Resseguradora S.A.**

## Financial statements

December 31, 2016 and 2015

### Contents

Management report of Austral Resseguradora S.A. ....	1
Independent auditor's report on financial statements .....	3
Audited financial statements	
Statement of financial position .....	6
Statements of income .....	8
Statements of comprehensive income .....	9
Statements of changes in equity .....	10
Cash flow statements.....	11
Notes to financial statements .....	12
Independent actuaries' opinion .....	64

## Management Report

Pursuant to legal and regulatory provisions, we hereby present the financial statements for the year ended December 31, 2016.

Austral Resseguradora S.A. ("Austral Re") was authorized by Brazil's Private Insurance Supervisory Office (SUSEP) to operate the reinsurance and the retrocession business on February 1, 2011 through SUSEP Administrative Ruling No. 3908.

Austral Re is a local reinsurer that provides, in addition to reinsurance capabilities, a service focused on the need of each one of its customers, performing a responsible underwriting and seeking efficiencies in capital allocation and market development, all in line with ongoing and careful risk management.

Reinsurance premiums, net of commissions, reached R\$401.9 million while earned premiums reached R\$394.2 million. Overall loss ratio was 67% (claims incurred/earned premiums net of reinsurance commission). It is also worth highlighting the gain of scale and efficiency that already conducted the operating and administrative expense level to 3.6% in relation to earned premium. Profit before taxes and before profit sharing was R\$45.0 million, and net income for the year was R\$33.8 million. The Company's combined ratio was 96.8%, remaining below 100% for the third year in a row, after only 6 years of operations. At the end of the year, Austral Re's equity totaled R\$282.6 million.

The investment policy adopted by Austral Re, which is in line with the Company's business and compliant with current regulations, produced financial income worth R\$36.9 million. Management represents the Company has financial capacity that supports the forecast for the next years. In addition, management represents that there is no marketable security classified as "Held to maturity" for this six-month period.

According to its initial business plan, Austral Re is set on keeping its market growth and consolidation path, sustaining its technical underwriting policy and seeking portfolio diversification in order to reduce its volatility.

As part of its profit reinvestment policy, the Company is set on reinvesting part of the net income in its own business. According to Austral Re's Articles of Incorporation, shareholders are entitled to receive as mandatory minimum dividends an amount equivalent to 25% (twenty-five per cent) of net income for each year ended December 31, adjusted under the terms of Brazilian Corporation Law.



Finally, Austral Re thanks its team for all effort and dedication, Brazil's Private Insurance Supervisory Office (SUSEP) and other insurance industry authorities for the assistance and guidance provided during this year, as well as its customers, business partners, suppliers and shareholders for the confidence placed in the Company.

Rio de Janeiro, February 21, 2017.

Management.



Centro Empresarial PB 370  
Praia de Botafogo, 370  
5° ao 10° andar - Botafogo  
22250-040 - Rio de Janeiro - RJ - Brazil  
Phone: +55 21 3263-7000  
ey.com.br

**A free translation from Portuguese into English of Independent Auditor's Report on financial statements prepared in Brazilian currency in accordance with accounting practices adopted in Brazil applicable to entities supervised by Brazil's Private Insurance Supervisory Office (SUSEP).**

---

## **Independent auditor's report on financial statements**

The Shareholders, Board of Directors and Officers  
**Austral Resseguradora S.A.**

### **Opinion**

We have audited the financial statements of Austral Resseguradora S.A. ("Company"), which comprise the statement of financial position as at December 31, 2016, and the statement of income, statement of comprehensive income, statement of changes in equity and cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting practices.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of Austral Resseguradora S.A. as at December 31, 2016, and its financial performance and its cash flows for the year then ended in accordance with accounting practices adopted in Brazil applicable to entities under Brazil's Private Insurance Supervisory Office (SUSEP).

### **Basis for opinion**

We conducted our audit in accordance with Brazilian and International Standards on Auditing. Our responsibilities under those standards are further described in the "Auditor's responsibilities for the audit of financial statements" section of our report. We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the Code of Professional Ethics for Accountants, the professional standards issued by Brazil's National Association of State Boards of Accountancy (CFC) and we have fulfilled our other responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide basis for our opinion.

### **Other information accompanying the financial statements and the auditor's report**

Management is responsible for such other information that is included in the Management Report.

Our opinion on the financial statements does not cover the Management Report and we do not express any form of audit conclusion on this report.

In connection with the audit of the financial statements, our responsibility is to read the Management Report and, in so doing, to consider whether this report is materially inconsistent with the financial statements or with our knowledge obtained in the audit or otherwise appear to contain material misstatements. If, based on our work, we conclude that there is a material misstatement in the Management Report, we are required to report this fact. We have nothing to report in respect of this matter.



## **Responsibilities of management and those charged with governance for the financial statements**

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting practices adopted in Brazil applicable to entities under Brazil's Private Insurance Supervisory Office (SUSEP), and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no other realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company's financial reporting process.

## **Auditor's responsibilities for the audit of financial statements**

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Brazilian and International standards on auditing will always detect material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with Brazilian and International standards on auditing, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:


- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit 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 Company's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the corresponding transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal controls that we identify during our audit.

Rio de Janeiro, February 21, 2017.

ERNST & YOUNG  
Auditores Independentes S.S.  
CRC-2SP015199/F-6



Marcelo Felipe L. de Sá  
Accountant CRC-1RJ094644/O-0

## Austral Resseguradora S.A.

### Statement of financial position December 31, 2016 and 2015 (In thousands of reais)

	<b>12/31/2016</b>	<b>12/31/2015</b>
Assets		
Current assets	<b>787,916</b>	711,908
Cash and cash equivalents	<b>34,699</b>	27,059
Cash and banks	<b>34,699</b>	27,059
Short-term investments (Note 6)	<b>304,139</b>	275,261
Fixed-income securities - government	<b>243,741</b>	224,149
Investment fund shares	<b>60,398</b>	51,112
Receivables from reinsurance operations (Note 8)	<b>254,699</b>	251,351
Insurers	<b>194,979</b>	189,802
Reinsurers	<b>59,720</b>	61,549
Retrocession assets - technical reserves (Notes 9 and 15)	<b>175,355</b>	140,557
Unearned premium reserve	<b>87,787</b>	75,706
Outstanding claims reserve	<b>69,304</b>	47,856
Incurred but not reported claims reserve	<b>15,849</b>	14,270
Technical Excess Earnings Reserve (PET)	<b>2,415</b>	2,725
Securities and credits receivable	<b>14,453</b>	12,912
Receivables	<b>2,455</b>	1,820
Tax credits (Note 10)	<b>11,936</b>	11,040
Other receivables	<b>62</b>	52
Deferred acquisition costs	<b>4,571</b>	4,768
Deferred brokerage (Note 11)	<b>4,571</b>	4,768
Noncurrent assets	<b>79,589</b>	104,987
Long-term receivables	<b>78,671</b>	103,928
Short-term investments (Note 6)	<b>38,352</b>	47,622
Fixed-income securities - government	<b>38,352</b>	47,622
Receivables from reinsurance operations (Note 8)	<b>13,908</b>	20,209
Insurers	<b>13,908</b>	20,209
Retrocession assets - technical reserves (Notes 9 and 15)	<b>26,204</b>	35,424
Unearned premium reserve	<b>19,404</b>	35,424
Outstanding claims reserve	<b>6,800</b>	-
Deferred acquisition costs	<b>207</b>	673
Deferred brokerage (Note 11)	<b>207</b>	673
Property and equipment (Note 12)	<b>497</b>	390
Personal properties	<b>497</b>	390
Intangible assets (Note 13)	<b>421</b>	669
Other intangible assets	<b>421</b>	669
Total assets	<b>867,505</b>	816,895



	<b>12/31/2016</b>	<b>12/31/2015</b>
Liabilities and equity		
Current liabilities	<b>526,822</b>	481,334
Accounts payable	<b>7,186</b>	9,566
Liabilities payable	<b>5,283</b>	7,187
Taxes and social charges payable	<b>1,036</b>	221
Labor charges	<b>543</b>	466
Taxes and contributions	<b>324</b>	1,692
Reinsurance payables	<b>133,244</b>	133,231
Refundable premium	<b>1,221</b>	21
Insurers	<b>67</b>	-
Reinsurers (Note 14)	<b>122,886</b>	123,892
Insurance and reinsurance brokers	<b>6,837</b>	7,471
Other operating payables	<b>2,233</b>	1,847
Third-party deposits	<b>143</b>	256
Third-party deposits	<b>143</b>	256
Technical reserves - reinsurance (Note 15)	<b>386,249</b>	338,281
Unearned premium reserve	<b>154,439</b>	134,390
Outstanding claims reserve (PSL)	<b>143,281</b>	124,733
Incurred but not reported claims reserve (IBNR)	<b>80,987</b>	72,821
Technical Excess Earnings Reserve (PET)	<b>7,542</b>	6,337
Noncurrent liabilities	<b>58,108</b>	69,174
Accounts payable	<b>7,330</b>	5,632
Deferred taxes	<b>7,330</b>	5,632
Reinsurance payables	<b>13,019</b>	18,934
Reinsurers (Note 14)	<b>13,004</b>	18,934
Insurance and reinsurance brokers	<b>15</b>	-
Technical reserves with reinsurers (Note 15)	<b>37,759</b>	44,608
Unearned premium reserve	<b>24,683</b>	40,518
Outstanding claims reserve (PSL)	<b>13,076</b>	4,090
Equity (Note 17)	<b>282,575</b>	266,387
Capital	<b>220,179</b>	209,479
Capital increase under approval	<b>-</b>	10,700
Capital reserve	<b>2,273</b>	1,962
Income reserves	<b>60,216</b>	46,592
Marketable securities adjustments	<b>(93)</b>	(2,346)
Total liabilities and equity	<b>867,505</b>	816,895

See accompanying notes.

## Austral Resseguradora S.A.

### Income statements

Years ended December 31, 2016 and 2015

(In thousands of reais, except for earnings per share, expressed in reais)

	<b>12/31/2016</b>	<b>12/31/2015</b>
Gross written premium	<b>401,939</b>	467,869
Changes in technical reserves	<b>(7,773)</b>	(1,602)
Earned premiums (Note 20 and 22a)	<b>394,166</b>	466,267
Incurring claims (Note 22b)	<b>(298,713)</b>	(313,263)
Acquisition costs (Note 22c)	<b>(9,891)</b>	(9,730)
Other operating income and expenses (Note 22d)	<b>16,191</b>	(98,633)
Retrocession result (Note 22e)	<b>(73,390)</b>	(9,968)
Administrative expenses (Note 22f)	<b>(14,000)</b>	(12,307)
Tax expenses (Note 22g)	<b>(6,286)</b>	(6,464)
Financial result (Note 22h)	<b>36,897</b>	52,701
Loss on disposal of property and equipment	-	(608)
(=) Income before taxes and profit sharing	<b>44,974</b>	67,995
Income tax (Note 18)	<b>(4,178)</b>	(12,062)
Social contribution tax (Note 18)	<b>(4,586)</b>	(8,500)
Profit sharing (Note 18)	<b>(2,421)</b>	(4,176)
(=) Net income for the year	<b>33,789</b>	43,257
Number of shares	<b>211,100,409</b>	211,100,409
Earnings per share		
Basic - Earnings per thousand shares - in reais	<b>0.16</b>	0.20

See accompanying notes.

## Austral Resseguradora S.A.

Statements of comprehensive income  
Years ended December 31, 2016 and 2015  
(In thousands of reais)

	<u>12/31/2016</u>	<u>12/31/2015</u>
Net income for the year	<u>33,789</u>	<u>43,257</u>
Other comprehensive income to be reclassified to P&L in subsequent periods		
Changes in fair value of financial assets available for sale	4,097	(4,544)
Income and social contribution tax effect	<u>(1,844)</u>	<u>2,031</u>
Other comprehensive income for the year, net of taxes	<u>2,253</u>	<u>(2,513)</u>
Total other comprehensive income for the year, net of taxes	<u><u>36,042</u></u>	<u><u>40,744</u></u>

See accompanying notes.

## Austral Resseguradora S.A.

Statements of changes in equity  
 Years ended December 31, 2016 and 2015  
 (In thousands of reais)

	Capital	Capital (under approval)	Capital reserve	Income reserves		Marketable securities adjustments	Retained earnings	Total
				Legal reserve	Retained profit reserve			
Balances at December 31, 2014	209,479	-	1,300	1,634	16,009	167	-	228,589
Capital increase (Note 17.a)	-	10,700	-	-	-	-	-	10,700
Net income for the year	-	-	-	-	-	-	43,257	43,257
Stock option plan (Note 21)	-	-	662	-	-	-	-	662
Unrealized gains on securities available for sale	-	-	-	-	-	(2,513)	-	(2,513)
Proposed profit allocation								
Recognition of legal reserve	-	-	-	2,163	-	-	(2,163)	-
Recognition of income reserve	-	-	-	-	26,786	-	(26,786)	-
Interest on equity (Note 17.c)	-	-	-	-	-	-	(14,308)	(14,308)
Balances at December 31, 2015	<b>209,479</b>	<b>10,700</b>	<b>1,962</b>	<b>3,797</b>	<b>42,795</b>	<b>(2,346)</b>	-	<b>266,387</b>
Capital increase (Note 17.a)	<b>10,700</b>	<b>(10,700)</b>	-	-	-	-	-	-
Net income for the year	-	-	-	-	-	-	33,789	33,789
Stock option plan (Note 21)	-	-	311	-	-	-	-	311
Unrealized gains on securities available for sale	-	-	-	-	-	2,253	-	2,253
Proposed profit allocation								
Recognition of legal reserve	-	-	-	1,690	-	-	(1,690)	-
Recognition of income reserve	-	-	-	-	11,934	-	(11,934)	-
Interest on equity (Note 17.c)	-	-	-	-	-	-	(20,165)	(20,165)
Balances at December 31, 2016	<b>220,179</b>	-	<b>2,273</b>	<b>5,487</b>	<b>54,729</b>	<b>(93)</b>	-	<b>282,575</b>

See accompanying notes.

## Austral Resseguradora S.A.

### Cash flow statements

Years ended December 31, 2016 and 2015

(In thousands of reais)

	12/31/2016	12/31/2015
Cash flow from operating activities		
Net income for the year	33,789	43,257
Adjustments to:		
Loss on disposal of property and equipment	-	608
Depreciation and amortization	395	667
Stock option plan	311	662
	<b>34,495</b>	45,194
Changes in balance sheet accounts		
Financial assets	(17,354)	(46,740)
Receivables from reinsurance operations	2,953	(11,049)
Retrocession assets - technical reserves	(25,578)	(24,240)
Deferred tax assets	1,698	3,820
Securities and credits receivable	(1,541)	(11,907)
Deferred brokerage	663	(1,266)
Taxes and contributions	9,642	19,067
Payables for reinsurance operations	(5,902)	7,584
Accounts payable	(3,390)	(11,522)
Technical reserves with reinsurers	41,119	57,406
Third-party deposits	(114)	55
Income and social contribution taxes paid	(10,195)	(19,234)
Net cash provided by operating activities	<b>26,496</b>	7,168
Cash flow from investing activities		
Cash receipt from disposal of property and equipment	-	16
Acquisition of property and equipment	(251)	(9)
Acquisition of intangible assets	(3)	(270)
Net cash used in investing activities	<b>(254)</b>	(263)
Cash flow from financing activities		
Capital increase under approval	-	10,700
Payment of interest on equity	(18,602)	(2,351)
Net cash provided by (used in) financing activities	<b>(18,602)</b>	8,349
Net increase in cash and cash equivalents	<b>7,640</b>	15,254
Cash and cash equivalents at beginning of year	<b>27,059</b>	11,805
Cash and cash equivalents at end of year	<b>34,699</b>	27,059

See accompanying notes.

## **Austral Resseguradora S.A.**

Notes to financial statements  
December 31, 2016 and 2015  
(In thousands of reais)

### **1. Operations**

Austral Resseguradora S.A. (“Company”, “Austral Re” or “Reinsurer”) is a privately-held corporation headquartered in the city and state of Rio de Janeiro, Brazil, engaged in reinsurance and retrocession operations in all insurance lines, pursuant to the legislation currently in force, across Brazil, and may hold equity interests in other companies as a member or shareholder.

On January 31, 2011, SUSEP Administrative Ruling No. 3.908 approved the resolutions made by the Company’s shareholders at the Special General Meeting held on December 27, 2010, as well as the authorization for Austral Resseguradora S.A. to operate the reinsurance and the retrocession business.

On October 6, 2011 Austral Participações S.A. became the holder and owner of 100% of the Company’s shares, as shown in the share transfer book.

On September 5, 2014, the shareholders of Austral Participações S.A. approved the participation of International Finance Corporation - IFC as a shareholder of the Company, upon increase in capital of Austral Participações S.A. by R\$79,000.

The International Finance Corporation’s indirect acquisition of a qualifying holding in Austral Resseguradora S.A. was ratified by SUSEP Administrative Ruling No. 6.130/2014, as published in the Federal Register on December 24, 2014. The Administrative Ruling also ratified there was no change in the control structure of Austral Participações S.A.

### **2. Presentation and preparation of financial statements**

#### **a) Going concern considerations**

Management evaluated the Reinsurer's ability to continue as a going concern and is convinced that the Reinsurer is able to continue as a going concern in the future. Furthermore, management is not aware of any material uncertainty that may cast significant doubt upon the Reinsurer’s ability to continue as a going concern. Therefore, the financial statements were prepared based on this principle.

## **Austral Resseguradora S.A.**

Note to financial statements (Continued)  
December 31, 2016 and 2015  
(In thousands of reais)

### **2. Presentation and preparation of financial statements (Continued)**

#### b) Statement of compliance

The financial statements were prepared according to the provisions of SUSEP Circular No. 517 of July 30, 2015, accounting pronouncements, guidance and interpretations issued by the Brazilian Financial Accounting Standards Board - FASB ("CPC"), and rules of Brazil's National Council for Private Insurance (CNSP) (hereinafter "accounting practices adopted in Brazil applicable to entities under SUSEP supervision").

SUSEP Circular No. 517, issued on July 30, 2015, and subsequent amendments, provides for amendments to accounting standards to be complied with by open-ended private pension plan entities, companies working with certificate accounts with lottery prizes, insurance and local reinsurance companies, effective as from its publication date. Such Circular repeals SUSEP Circular No. 508 issued on January 9, 2015.

The authorization to complete the preparation of these financial statements was given by Company management on February 21, 2017.

#### c) Functional and reporting currency

The Reinsurer's functional currency is the Real (R\$). This is the currency of the main economic environment in which the Reinsurer operates. Transactions in foreign currency are initially translated at the exchange rate to the functional currency at the transaction date. Monetary assets and liabilities stated in foreign currency are translated into the functional currency at the exchange rate in force at the closing date of the statement of financial position. Differences arising from the translation are posted directly against P&L for the year.

#### d) Measurement basis

The amounts in the financial statements are expressed in Brazilian reais (R\$), rounded to thousands (R\$000), unless otherwise state, and were prepared on a historical cost basis, except the following material items recognized in the balance sheet:

- Financial instruments measured at fair value through profit or loss;
- Financial assets available for sale measured at fair value;
- Technical reserves measured according to SUSEP guidelines.
- Receivables.

## **Austral Resseguradora S.A.**

Notes to financial statements (Continued)  
December 31, 2016 and 2015  
(In thousands of reais)

### **2. Presentation and preparation of financial statements (Continued)**

#### d) Measurement basis (Continued)

Pursuant to CPC 11 - Insurance Contracts, the Reinsurer applied the accounting practices adopted in Brazil to its reinsurance contracts, in accordance with the rules issued by Brazil's National Council for Private Insurance (CNSP) and by Brazil's Private Insurance Supervisory Office (SUSEP).

The preparation of financial statements requires management to make judgments in determining and recording accounting estimates.

Significant assets and liabilities subject to these estimates and assumptions include, among others, assessment of liabilities underlying reinsurance contracts, determination of fair value of financial assets, impairment tests of non-financial assets, provision for contingencies and deferred taxes.

Settlement of transactions involving these estimates may differ from the estimated value due to uncertainties inherent in the estimation process, as mentioned in Note 04.

### **3. Summary of significant accounting practices**

Significant accounting practices adopted in the preparation of these financial statements are described below. These practices have been consistently applied to all comparative periods presented herein.

#### a) Cash and cash equivalents

Cash and cash equivalents include cash and positive balances in checking accounts, with insignificant risk of change in fair value. These are used by the Company to manage its short-term commitments.



## Austral Resseguradora S.A.

Notes to financial statements (Continued)  
December 31, 2016 and 2015  
(In thousands of reais)

### 3. Summary of significant accounting practices (Continued)

#### b) Financial assets

The classification of the financial assets depends on the purpose for which they were acquired. Management determines the classification of financial assets on the initial date of acquisition and reassesses their classification at least at each balance sheet date. The Reinsurer classifies its financial assets in accordance with the categories under CPC 38 - Financial Instruments: Recognition and Measurement:

#### I. *Securities measured at fair value through profit or loss*

Financial assets at fair value through P&L are financial assets held for trading. A financial asset is classified in this category if it was acquired particularly to be sold in the short term, and is initially recognized at fair value. These assets are measured at restated cost, plus yields, and subsequently measured at fair value, with changes in fair value posted directly to P&L for the period. Transaction costs incurred in the acquisition of financial assets classified under this category are immediately posted to P&L for the period as incurred. Securities under this category are classified as current assets, irrespective of their maturity dates.

#### II. *Securities available for sale*

The Reinsurer classifies in this category all non-derivative financial assets not designated in the previous category. After initial recognition, they are measured at fair value and any changes other than those arising from impairment are recognized directly in equity, except for interest on AFS assets (which is recognised in income on an effective yield basis), impairment losses and (for interest-bearing AFS debt instruments) foreign exchange gains or losses. The cumulative gain or loss that was recognised in equity is recognised in profit or loss when an available-for-sale financial asset is derecognized.

## Austral Resseguradora S.A.

Notes to financial statements (Continued)  
December 31, 2016 and 2015  
(In thousands of reais)

### 3. Summary of significant accounting practices (Continued)

#### b) Financial assets (Continued)

##### III. *Receivables*

Receivables are nonderivative financial assets with fixed or determinable payments that are not quoted in an active market. They are recorded under current assets, except for those with maturity exceeding twelve months from the balance sheet date (these are classified as noncurrent assets). Receivables arising from reinsurance and retrocession contracts, such as balance of premiums receivable from insurers and reinsurers, are classified by the Reinsurer under this category, initially measured at fair value and, subsequently, at amortized costs less provision for impairment. In practice, receivables are usually recognized at the value determined upon acceptance of the contract, adjusted by the provision for impairment, if necessary.

#### c) Derivative financial instruments

Derivative financial instruments designated in hedging transactions are initially recognized at fair value on the date the derivative contract is entered into and are subsequently remeasured at fair value.

Upon initial recognition of a hedging relationship, the Reinsurer formally classifies and documents relationship to which it intends to apply the hedge accounting, as well as risk management objective and strategy of Management to implement the hedge. The documentation includes identification of the hedging instrument, the hedged item or transaction, the nature of the risk being hedged, the nature of the risks excluded from the hedging relationship, the prospective assessment of the effectiveness of the hedging relationship and how the Company will assess the effectiveness of the hedging instrument in offsetting the exposure to changes in the hedged item's fair value.

The Reinsurer had no derivative financial instruments at the balance sheet closing date and did not conduct any transactions involving derivative instruments for the years ended December 31, 2016 and 2015.

## Austral Resseguradora S.A.

Notes to financial statements (Continued)  
December 31, 2016 and 2015  
(In thousands of reais)

### 3. Summary of significant accounting practices (Continued)

#### d) Recognition and measurement of reinsurance contracts

Reinsurance contracts are represented by policies whereby the Reinsurer agrees with an insurer to accept a sole risk or a risk portfolio, or even part of the risk. Under such contracts, the Reinsurer agrees to pay compensations on claims covered by the cedent, as supported by the reinsurance contract. In general, the Reinsurer determines whether the reinsurance risk is significant by comparing premiums received with claims payable, if the insured event had taken place.

Reinsurance contracts aim at safeguarding the insurers' interests by reducing their volatility, expanding capacity, reducing required capital and exchanging expertise, among others.

For purposes of facultative and non-proportional treaties, reinsurance premiums and acquisition costs are recorded at the moment the contract is accepted. The amount of earned premiums is recognized in P&L in accordance with the coverage period elapsed.

In case of proportional treaties, the premium actually ceded to the reinsurer is known on a subsequent date. Accordingly, premiums are consistently issued over the term of the contract, based on the estimate informed by the cedent upon acceptance thereof, except when there is a seasonal variation. Therefore, the amount of earned premiums recognized in the income statement arises from the issuing standard described above.

#### e) Retrocession assets and liabilities

Retrocession assets consist of receivables from reinsurers in the short and long term, depending on the time expected for realization or receipt of assets from retrocessionaires. Retrocession assets are consistently evaluated with reinsurance liabilities submitted to retrocession and with the terms and conditions of each contract. Liabilities payable to retrocessionaires comprise mainly premiums payable in retrocession contracts, consistent with the value of reinsurance assets to the extent that they are retroceded. Any gains or losses from the retrocession contracts are amortized during the coverage period of contract risks.

## Austral Resseguradora S.A.

Notes to financial statements (Continued)  
December 31, 2016 and 2015  
(In thousands of reais)

### 3. Summary of significant accounting practices (Continued)

#### e) Retrocession assets and liabilities (Continued)

The Reinsurer analyzes the recoverability of the retrocession assets regularly at least at each balance sheet date. When there is objective evidence of impairment, the Reinsurer reduces the carrying amount of the retrocession asset to the estimated recoverable amount and immediately recognizes any loss in P&L for the year.

For the years ended December 31, 2016 and 2015, it wasn't necessary to recognize a provision for impairment on the Company's reinsurance and retrocession assets.

#### f) Reinsurance liabilities

The Reinsurer relied on the guidance of CPC 11 - Insurance Contracts to assess its reinsurance contracts and translate its financial statements, applying the basic rules for assessing reinsurance contracts, e.g., liability adequacy test, retrocession assets impairment, checking whether the retention limit adopted is adequate, among other applicable policies.

Also, management did not find any situations where excessive prudence has been used to assess reinsurance contracts. Technical reserves from reinsurance contracts, according to the accounting practices adopted in Brazil applicable to entities under Brazil's Private Insurance Supervisory Office (SUSEP) supervision and generally accepted actuarial concepts, applicable to local reinsurers authorized by SUSEP to operate, are established in accordance with the guidelines of CNSP and of SUSEP.

The calculation methods of each technical reserve are described in an actuarial technical note prepared by the actuary in charge and in accordance with CNSP Ruling No. 321 of July 15, 2015 (as amended) and SUSEP Circular No. 517 of July 30, 2015 (as amended), as specified below:

#### · *Unearned Premium Reserve (PPNG)*

This is recognized to cover payables related to future claims and expenses over the life of policies for risks assumed at the evaluation date, including the estimation of reinsurance contracts in force and not issued. In order to calculate the portion of reinsurance contracts in force already issued, the Company used different methodologies for each type of reinsurance contract and the exposure to each contract risk, in line with the SUSEP standards and guidance.

## Austral Resseguradora S.A.

Notes to financial statements (Continued)  
December 31, 2016 and 2015  
(In thousands of reais)

### 3. Summary of significant accounting practices (Continued)

#### f) Reinsurance liabilities (Continued)

##### · *Unearned Premium Reserve (PPNG) (Continued)*

The unearned premium reserve for reinsurance contracts in force but not issued (PPNG - RVNE) is estimated only for facultative contracts, using the average rate of delay noted in the Reinsurer's portfolio. The average delay factor subjectively selected is applied to the unearned premium reserve for reinsurance contracts issued in order to derive the PPNG-RVNE. This calculation method allows promptly adjusting the reserve to any inconsistency determined in the related consistency tests for the previous months.

##### · *Outstanding Claims Reserve (PSL)*

It consists of the cedent's best estimate for the amount payable by the Reinsurer adjusted to market experience and, for claims reported on an individual basis, to the determination of the amount informed by the cedent under Company's regulation.

##### · *Incurred But Not Reported Claims Reserve (IBNR)*

It aims at estimating the Reinsurer's responsibility for claims already incurred, but not yet reported. The IBNR is calculated based on the type of contract, using a similar method of standard percentage rates established in SUSEP Circular No. 517 of July 30, 2015. However, Austral Re uses alternative methodologies for certain types of contracts/business lines with specific characteristics to better reflect the expected IBNR for these cases.

##### · *Technical Excess Earnings Reserve (PET)*

This is intended to provision amounts owed by reference to contract earnings. This concept includes the payment in profit commissions, claims bonus and sliding scale commissions. This reserve is calculated per contract on the evaluation date of these amounts and in accordance with specific criteria established in each contract. The reserve for these amounts is adjusted or reversed as the related amounts are confirmed with the cedents or retrocessionaires or actually paid or received.

## Austral Resseguradora S.A.

Notes to financial statements (Continued)  
December 31, 2016 and 2015  
(In thousands of reais)

### 3. Summary of significant accounting practices (Continued)

f) Reinsurance liabilities (Continued)

· *Related Expenses Reserve (PDR)*

This is recognized on a monthly basis to cover expenses relating to payment of damages or benefits and covers not only expenses that may be attributed to each individual claim but also expenses that may only relate to groups of claims.

g) Deferred brokerage

Acquisition costs are recorded upon acceptance of the contracts and allocated to P&L in accordance with the coverage period elapsed. These brokerages are deferred using the same method adopted for premium deferral.

The table below shows two group average deferral periods:

- Average policy's period included in reinsurance contracts, used for deferral of written premium in a certain month; and
- Total average deferral period for reinsurance contracts, i.e., total average period for the premium of a certain contract to be fully earned.

Groups	December 31, 2016		December 31, 2015	
	Average of Policy's period included in reinsurance contracts (in months)	Total average deferral period for reinsurance contracts (in months)	Average of policy's period included in reinsurance contracts (in months)	Total average deferral period for reinsurance contracts (in months)
Property	8	24	16	24
Special risks	1	13	14	15
Liabilities	6	19	13	21
Motor	12	24	12	25
Transportation	10	22	12	26
Financial risks	36	48	36	48
Life – Group	5	17	9	10
Agro	6	17	6	18
Other	9	19	9	15
Marine	12	25	12	23
Aviation	7	24	13	19

## Austral Resseguradora S.A.

Notes to financial statements (Continued)  
December 31, 2016 and 2015  
(In thousands of reais)

### 3. Summary of significant accounting practices (Continued)

#### h) Recognition of claims and expenses

Claims from reinsurance include all events incurred during the period, either reported or not, the related internal and external costs with treatment of claims directly related to processing and settlement thereof, the reduced amount consisting of salvage recoveries and other recoveries and any adjustments to prior periods' unsettled claims.

#### i) Property and equipment

Property and equipment are measured at historical cost, less accumulated depreciation. Such cost includes expenses directly attributable to the acquisition of assets. Subsequent costs are included in an asset's carrying amount or recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Company and the cost of the item can be reliably measured. The book value of replaced items or parts is written off. All other repair and maintenance costs are matched against P&L for the period, as incurred.

Depreciation of other assets is calculated using the straight-line method.

When the carrying amount of an asset exceeds its recoverable amount, the asset is immediately reduced to its recoverable amount.

#### j) Intangible assets

Software maintenance costs are recognized as expenses, when incurred. Development costs that are directly attributable to the design and testing of identifiable and unique software products, controlled by the Company, are recognized as intangible assets when the following criteria are met:

- It is technically feasible to complete the software so that it is available for use.
- Management intends to complete the software and use it.
- Future economic benefits associated with the software can be demonstrated.
- Adequate technical, financial and other resources are available to complete the development of and use or sell the software;

## Austral Resseguradora S.A.

Notes to financial statements (Continued)  
December 31, 2016 and 2015  
(In thousands of reais)

### 3. Summary of significant accounting practices (Continued)

#### j) Intangible assets (Continued)

- The expense attributable to the software during its development can be reliably measured.

Directly attributable costs, capitalized as a portion of the software product include development costs and an appropriate portion of applicable direct expenses

Other development expenditures that do not meet these criteria are recognized as expenses, when incurred. Development costs previously recognized as expenses are not recognized as assets in subsequent periods.

Software development costs recognized as assets are amortized throughout their estimated useful life.

#### k) Impairment of financial assets

Upon balance sheet closing, the Reinsurer assesses whether there is objective evidence that a certain financial asset or group of financial assets is impaired. A financial asset or a group of financial assets is deemed to be impaired and the impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred since the initial recognition of the asset.

#### l) Assets carried at amortized cost

If there is objective evidence that an impairment loss has been incurred for assets carried at amortized cost, the amount of the loss is measured as the difference between the assets' carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not yet been incurred), discounted at the financial assets' original effective interest rate. The carrying amount of the asset is reduced and the loss is recognized in the income statement.



## **Austral Resseguradora S.A.**

Notes to financial statements (Continued)  
December 31, 2016 and 2015  
(In thousands of reais)

### **3. Summary of significant accounting practices (Continued)**

#### **l) Assets recorded at amortized cost (Continued)**

The Company first assesses whether there is objective evidence of impairment for each financial assets individually that are individually significant, or collectively for financial assets that are not individually significant. If the Company determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Impairment loss, if any, is always assessed at the balance sheet date.

For impairment purposes, the Company classifies reinsurance and retrocession premiums receivable based on economic studies of losses incurred, default risks, among other aspects. The provision for impairment will be recorded when necessary, according to SUSEP Circular No. 517 of July 30, 2015.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment loss is reversed. Any subsequent reversal of an impairment loss is recognized in the income statement, to the extent that the carrying amount of the asset does not exceed its amortized cost at the reversal date.

#### **m) Income and social contributions taxes**

Current tax assets and liabilities for prior years and six-month period are measured at the amount expected to be recovered from or paid to the tax authorities. Income tax was calculated based on net income for the period, at the rate of 25%. Social contribution tax was calculated based on net income for the period, at the rate of 15% up to August 2015, and 20% as from September 2015, adjusted for additions and exclusions determined by tax legislation in force. Deferred income and social contribution taxes reflect the effects of temporary differences as of the balance sheet date between tax bases of assets and liabilities and their carrying amounts.

## Austral Resseguradora S.A.

Notes to financial statements (Continued)  
December 31, 2016 and 2015  
(In thousands of reais)

### 3. Summary of significant accounting practices (Continued)

#### m) Income and social contributions taxes (Continued)

Deferred tax assets are recognized for all deductible temporary differences, unused tax credits and tax losses to the extent that it is probable that temporary differences will be reversed in a near future and taxable profit will be available so that the deductible temporary differences may be realized and unused tax credits and losses may be used. Temporary differences will be used to reduce or increase future taxable profits. The Company evaluates, on a semiannual basis, the amount of deferred income and social contribution tax assets in relation to its operating performance and projected taxable profit and, when necessary, reduces the amounts to the expected realizable value.

#### n) Liability adequacy test

As required by CPC 11 - Insurance Contracts, at each balance sheet date, the Reinsurer evaluates the obligations in connection with the reinsurance contracts in force at the reporting date through a liability adequacy test. Brazil's Private Insurance Supervisory Office (SUSEP) introduced and defined the rule for preparation of this test by way of SUSEP Circular No. 517 of July 30, 2015, its amendments and guidelines.

The liability adequacy test (LAT) has been carried out with prudence and objectivity, using applicable, appropriate and significant statistical and actuarial methods, based on updated and true information and realistic considerations, consistently with observable information in the financial market.

In summary, the liability adequacy test (LAT) compares the estimated cash flows arising from the obligations undertaken by the Reinsurer to comply with reinsurance contracts, with the reserves established by the Reinsurer at the reporting date, net of deferred brokerage and related intangible assets.

The Reinsurer prepared a methodology that represents the best estimate of all future cash flows by using current, realistic and unbiased assumptions for each variable involved in the liability adequacy test and grouping the reinsurance contracts in view of the lines set forth in the regulation currently in force.

The Company has cash flows of rights and obligations in local currency and in US dollars. Consequently, the Brazilian Financial and Capital Markets Association (ANBIMA)'s fixed risk-free ETTJ index, disclosed by SUSEP, was applied for cash flow estimates at nominal values. Similarly, for estimates stemming from cash flows in US dollars the coupon curve in US dollar available on SUSEP website was used.

## **Austral Resseguradora S.A.**

Notes to financial statements (Continued)  
December 31, 2016 and 2015  
(In thousands of reais)

### **3. Summary of significant accounting practices (Continued)**

n) Liability adequacy test (Continued)

The liability adequacy test as of December 31, 2016 and 2015 indicated that the booked reserves, net of deferred brokerage and related intangible assets, are sufficient to secure the expected present value of cash flows in connection with the compliance with reinsurance contracts.

In addition, upon comparing the booked Unearned Premium Reserve (net of deferred brokerage and related intangible assets) with the present value of future losses related to in force business, no need to recognize Supplementary Coverage Reserve (PCC) was identified.

o) Other provisions, contingent assets and liabilities

Pursuant to CPC 25 - Provisions, Contingent Liabilities and Contingent Assets, a contingent provision for labor, civil and tax proceedings is recognized when there is a present (legal or constructive) obligation as a result of a past event, whose amount has been reliably estimated and it is probable that a cash outflow will be required to settle the obligation. If any of these conditions are not met, no provision shall be recognized.

Provisions are recognized based on a number of individual analyses, performed by the Company's legal advisors, of ongoing administrative and legal proceedings and based on the potential unfavorable outcomes leading to future disbursements. An increase in the liability due to the lapse of time is recognized as financial expenses.

Contingent assets, if any, are not recognized until there is a final positive outcome for the Company and when the realization of these assets is probable.

p) Determination of profit or loss (P&L)

Profit or loss is determined on an accrual basis and considers that reinsurance premiums are recorded in non-proportional and facultative contracts on the date of acceptance of covered risks. In case of proportional treaties, the premium actually ceded to the reinsurer is known on a subsequent date. Accordingly, premiums are consistently issued over the term of the contract, based on the estimate informed by the cedent upon acceptance thereof, except when there is a seasonal variation.

## Austral Resseguradora S.A.

Notes to financial statements (Continued)  
December 31, 2016 and 2015  
(In thousands of reais)

### 3. Summary of significant accounting practices (Continued)

p) Determination of profit or loss (P&L) - Continued

Reinsurance and retrocession premiums and the related acquisition costs are recognized in the income statement in accordance with the coverage period elapsed.

Gross written premium comprise total premiums receivable agreed in reinsurance contracts during the reporting period and adjustments which may arise during such period for premiums receivable in relation to premiums issued in prior reporting periods, in conformity with information provided by insurance companies.

In 2014, the Company started to recognize the premium amount relating to reinsurance contracts in force but not issued (Premium - RVNE), considering that its premium history has become more consistent and the amount of Premium - RVNE can be more reliably estimated. Written retrocession premiums comprise total premiums payable agreed in retrocession contracts during the reporting period and any adjustments from prior periods, consistently with reinsurance premiums under retrocession.

q) Earnings per share

In compliance with CPC 41 - Earnings per Share, the Company sets out below information on basic and diluted earnings per share for the years ended December 31, 2016 and 2015.

Basic earnings per share is calculated by dividing net income for the year, attributed to common shareholders, by the weighted average number of common shares available during the period. As at December 31, 2016 and 2015, the Company had no preferred shares.

The earnings per thousand shares calculation is shown in the income statements for the year.

To calculate diluted earnings per share, the Company adjusts profit attributable to common shareholders (common stock) of the Company, as well as the weighted average number of total (outstanding) shares held by the shareholder, to reflect the effects of all potential diluted common shares.

The purpose of diluted earnings per share is consistent with that of the basic earnings per share, which is to provide a measure of the participation of each common share in the Company's performance and, at the same time, to reflect the effects of all potential dilutive common shares outstanding in the period.

## **Austral Resseguradora S.A.**

Notes to financial statements (Continued)  
December 31, 2016 and 2015  
(In thousands of reais)

### **3. Summary of significant accounting practices (Continued)**

r) Stock option plan

Share-based payment to Reinsurer executives is measured and recognized at fair value as of the date options are granted, in a specific account in equity and income statement, as contractual conditions are met. The cost of transactions settled in shares is recognized over the year in which conditions are fulfilled, ending on the date the employee becomes entitled to the premium (vesting date). The cumulative expense recognized through the vesting date reflects the extent to which the vesting period has expired and the Insurer's best estimate of the number of shares to be acquired.

When share-based payment premium is canceled, it is treated as if it had been acquired on the cancellation date, and any expenses are immediately recognized. This includes any premium in which non-acquisition conditions within the control of the Reinsurer or the other party are not met. However, if a new plan replaces the canceled plan, and is designated as a substitute plan on granting date, the canceled plan and the new plan are treated as a change in the original plan.

## **Austral Resseguradora S.A.**

Notes to financial statements (Continued)  
December 31, 2016 and 2015  
(In thousands of reais)

### **4. Significant accounting judgments, estimates and assumptions**

The preparation of the financial statements requires using some accounting estimates and exercising a high degree of management judgment on using some accounting policies. However, uncertainty about these assumptions and estimates could result in outcomes that require a material adjustment to the carrying amount of assets or liabilities affected in future periods.

In the process of applying the Company's accounting policies, management has made the following judgments, besides those involving estimates and assumptions, which have the most significant effect on the amounts recognized in the financial statements.

a) Valuation of reinsurance contract liabilities

As permitted by CPC 11 - Insurance Contracts, the Company applied the accounting practices adopted in Brazil. The technical reserves that represent the reinsurance contract liabilities of the Company's insurance lines are as follows: unearned premium reserve (PPNG), unearned premium reserve for reinsurance contracts in force but not issued (PPNG-RVNE), outstanding claims reserve (PSL), incurred but not reported claims reserve (IBNR), related expenses reserve (PDR) and technical excess earnings reserve (PET).

The Company's technical reserves are calculated in accordance with methodologies widely known in the market, and are in accordance with all requirements and guidelines established by SUSEP. The behavior of the Company's reinsurance portfolio is monitored on a monthly basis in order to foresee and define proper criteria for measurement of its reserves.

## **Austral Resseguradora S.A.**

Notes to financial statements (Continued)  
December 31, 2016 and 2015  
(In thousands of reais)

### **4. Significant accounting judgments, estimates and assumptions (Continued)**

#### a) Valuation of reinsurance contract liabilities (Continued)

Claims will be analyzed taking into consideration the historical behavior based on market experience and may be further analyzed by main business line and type of claim. Large claims are usually separately addressed, either by being reserved at the face value of loss estimates or separately projected in order to reflect their future development.

Additional qualitative judgment is used to assess the extent to which past trends may not apply in the future (for example to reflect one-off occurrences, changes in external or market factors such as public attitudes to claiming, economic conditions, levels of claims inflation, judicial decisions and legislation, as well as internal factors such as portfolio mix, policy features and claims handling procedures) in order to arrive at the estimated ultimate cost of claims whose likelihood of loss is assessed as possible and probable, taking into account all of the uncertainties involved.

#### b) Reserve for recovery of reinsurance and retrocession operations

These reserves are grounded on an analysis of the history of losses monitored by management, and are established at an amount deemed to be sufficient to cover probable losses on realization of receivables from reinsurance and retrocession operations. At December 31, 2016 and 2015, there were no indications that the receivables would not be recovered.

#### c) Useful life of property and equipment and intangible assets

The depreciation or amortization of property and equipment and intangible assets considers management's best estimate of the use of these assets over its operations. Changes in the economic scenario and/or consumer market may require that the estimated useful life be reviewed.

## Austral Resseguradora S.A.

Notes to financial statements (Continued)  
December 31, 2016 and 2015  
(In thousands of reais)

### 4. Significant accounting judgments, estimates and assumptions (Continued)

#### d) Impairment of non-financial assets

Management tests the net carrying amount of the assets on a monthly basis with a view to determining whether there are any events or changes in economic, operating or technological circumstances that may indicate impairment. Where such evidence is identified, and the net carrying amount of an asset exceeds its recoverable amount, a provision for impairment is recognized and the net carrying amount is written down to its recoverable amount. As at December 31, 2016 and 2015, there were no indications of impairment loss on non-financial assets.

#### e) Provisions for contingencies

The Reinsurer is exposed to tax, civil and labor claims arising from the ordinary course of its business, and the assessment of related risks involves considerable judgment by management, for tax, civil and labor claims. As a result of a past event, it is probable that an outflow of economic benefits will be required to settle the obligation and a reasonable estimate can be made of the amount of that obligation.

The assessment of the likelihood of loss includes an analysis of available evidence, the hierarchy of laws, available case law, recent court decisions and their relevance in the legal system, as well as the opinion of outside legal advisors.

Provisions are reviewed and adjusted to take into account changes in circumstances, such as the applicable statute of barring period, tax audit conclusions or additional exposures identified based on new matters or court decisions. Actual results may differ from estimates.

Settlement of transactions involving these estimates may result in amounts significantly different from those recorded in the financial statements due to uncertainties inherent in the estimation process. The Company reviews its estimates and assumptions on a monthly basis.



## **Austral Resseguradora S.A.**

Notes to financial statements (Continued)  
December 31, 2016 and 2015  
(In thousands of reais)

### **5. Reinsurance and financial risk management**

#### a) Reinsurance risk management

The main risk the Reinsurer faces under reinsurance contracts is that actual claims payments differ from expectations. This is influenced by the frequency of claims, severity of claims, amounts actually paid and subsequent development of long-term claims. Therefore, the objective of the Reinsurer is to ensure that sufficient reserves are available to cover these liabilities.

The above risk exposure is mitigated by diversification across a large portfolio of reinsurance contracts. The risk diversification is also improved by careful selection and implementation of sound and prudent underwriting strategy guidelines, as well as the continuous monitoring for adjustment purposes.

The Reinsurer purchases retrocession as part of its program to reduce volatility and expand capacity. Ceded retrocession is placed on both a proportional and non-proportional basis. Proportional retrocession is primarily quota-share retrocession, whereby the Company retrocedes the risks in proportion to claims recovered. Non-proportional retrocession is primarily excess-of-loss retrocession, whereby the retrocessionaire agrees to pay the claim amount in excess of a given threshold (priority) contractually agreed upon, thus minimizing the Company's loss.

Amounts recoverable from retrocessionaires are estimated in a manner consistent with the outstanding claims reserve and are in accordance with the reinsurance contracts. Although the Company has retrocession contracts, it is not relieved of its direct obligations with its reinsurance contracts and thus a credit exposure exists with respect to ceded retrocession, to the extent that any retrocessionaire is unable to meet its obligations assumed under such retrocession contracts.

For reinsurance risk management, the Company adopts policies, processes and operating procedures to assess the risks involving its major lines of business. The underwriting policy drives decision-making, actions and procedures involved in underwriting the portfolio risks. The parameters adopted for preparing budget and defining targets (production, commissioning, loss ratio, results, etc.) are attainable, sustainable and consistent with the Company's structure and capital and aim at generating steady and continuous profits.

## Austral Resseguradora S.A.

Notes to financial statements (Continued)  
December 31, 2016 and 2015  
(In thousands of reais)

### 5. Reinsurance and financial risk management (Continued)

#### a) Reinsurance risk management (Continued)

The Company underwrites risks in all insurance lines' groups, considering the technical factors of each line and contract. The underwriting policy is supported by the portfolio's risk underwriting guidelines, underwriting procedures, and decision-making authority levels, which are formally approved, regularly reviewed and properly communicated to all levels of personnel involved.

For risk pricing purposes, with a view to obtaining results that are consistent, stable and positive both individually and for the portfolio as a whole, the Company adopts various models of pricing benchmarks, consolidated in the actuarial community. The main pricing methodologies include historical analysis, attrition and severity, exposure and experience.

#### b) Sensitivity test for operating activities

The Reinsurer's risk monitoring policy considers the periodical analysis of its investment portfolio in order to assess its volatility through changes, which may lead to significant changes in P&L.

According to Vinci Gestora de Recursos Ltda., a company that manages the Reinsurer's funds, such investments generated an exposure whose parametric Value at Risk (VAR) with 95% confidence level, one-business-day timeframe and a 252-business-day history was 0.19% of the portfolio equity, as mentioned in Note 5.e, or 0.25% with a confidence level of 99%. The Reinsurer analysis also considers its portfolio performance in stress scenarios of the main risk factors that make up its assets, as follows:

- Forward yield curve structure of the Extended Consumer Price Index (IPCA): variation of 300 basis points or 3% on an equal basis in all of the forward yield curve vertices of inflation - IPCA - inferred by the yield curve of National Treasury Notes (NTN-B);
- Foreign exchange variation: variation of 10% in the foreign exchange rate.

## Austral Resseguradora S.A.

Notes to financial statements (Continued)  
December 31, 2016 and 2015  
(In thousands of reais)

### 5. Reinsurance and financial risk management (Continued)

#### b) Sensitivity test for operating activities (Continued)

Scenario A (**)			Scenario B (**)		
Risk factors	Shock	Impact on P&L before taxes	Risk factors	Shock	Impact on P&L before taxes
Inflation	+300 bps (*)	(24,550)	Inflation	-300 bps(*)	24,550
Foreign exchange	+10%	3,460	Foreign exchange	-10%	(3,460)
Total		<u>(21,090)</u>	Total		<u>21,090</u>

(\*) Bps = basis points, where 1 bp = 0.01%

(\*\*) Information from the administrator of the Company's funds (Vinci Gestora de Recursos Ltda).

In addition to the aforementioned scenarios, the loss ratios observed in business lines directly impact P&L recorded by the Company in each period. To perform a sensitivity test, the Company assumed a 10% increase in the loss ratio reported for a group of reinsurance lines in the financial statements as at December 31, 2016 and 2015.

The table below presents the loss ratios used in the proposed sensitivity test:

- Loss ratio

Groups	December 31, 2016		
	Loss ratio increased by 10%	Changes in reinsurance losses	Change in claim, net of retrocession
Property	64.27%	3,969	1,840
Special risks	10.00%	797	304
Liabilities	17.68%	205	138
Motor	131.68%	999	1,018
Transportation	133.48%	3,197	1,343
Financial risks	7.55%	296	82
Life - Group	30.46%	1,964	850
Agro	80.71%	1,596	1,558
Other	154.45%	17,035	16,939
Marine	42.12%	240	533
Aviation	43.40%	393	29
Total		<u>30,691</u>	<u>24,634</u>

## Austral Resseguradora S.A.

Notes to financial statements (Continued)  
December 31, 2016 and 2015  
(In thousands of reais)

### 5. Reinsurance and financial risk management (Continued)

#### b) Sensitivity test for operating activities (Continued)

- Loss ratio (Continued)

Groups	December 31, 2015		
	Loss ratio increased by 10%	Changes in reinsurance claim	Changes in claim, net of retrocession
Property	110.4%	5,066	2,707
Special risks	7.3%	42	64
Liabilities	31.7%	102	88
Motor	91.8%	918	884
Transportation	91.7%	1,352	743
Financial risks	16.1%	627	90
Life – Group	22.5%	3,234	2,202
Agro	103.9%	4,992	-
Other	138.6%	14,570	1,271
Life - individual	10.0%	14	8,922
Marine	52.0%	170	86
Aviation	51.7%	255	143
Total		31,342	17,200

The impact on Reinsurer's P&L and equity after taxes and contributions at December 31, 2016, would be an increase in the Company's expense in the amount of R\$13,805 (R\$11,389 at December 31, 2015).

#### c) Financial risk management

The Reinsurer's investment policy sets forth the guidelines to allocate funds to marketable securities, as well as to monitor the risks inherent to its investment portfolio.

The investments rely on analysis of short-, medium- and long-term macroeconomic scenarios, observing the main variables of the Brazilian and global economy, e.g.: expectations for evolution of interest rates, inflation rates, exchange rates, and economic growth, among others.

The Reinsurer's investment decisions consider its cash needs and the matching between its assets and liabilities in light of a conservative behavior in relation to its counterparties' credit and investments made. The financial investment risks are managed through a daily analysis and monitoring of the portfolio.

## Austral Resseguradora S.A.

Notes to financial statements (Continued)  
December 31, 2016 and 2015  
(In thousands of reais)

### 5. Reinsurance and financial risk management (Continued)

c) Financial risk management (Continued)

The Reinsurer has an investment committee that meets to analyze the portfolio performance, design prospective scenarios and set the overall guidelines for investments in the upcoming months.

d) Credit risk

Credit risk consists of any losses resulting from agreed financial obligations not met by the counterparties. The credit risk analysis is based on the ratings assigned by credit rating agencies.

The Company conducts business only with reinsurers highly rated by rating agencies, and is engaged in operations with six local reinsurers, nineteen admitted reinsurers and twenty-seven eventual reinsurers. In this panel, the lowest ratings are as follows: Standard & Poor's (A-), Fitch (A-), Moody's (Baa1) and A.M Best Company (A-).

Additionally, the Reinsurer's exposure reaches R\$6,668 at December 31, 2016 (R\$8,637 at December 31, 2015), from business accepted in reinsurance, in which insurers are the counterparties. This credit risk exposure was calculated in accordance with article 5, attachment I of CNSP Ruling No. 321 of July 15, 2015.

e) Market risk

Market risk consists of losses from unfavorable fluctuation of the value of the Reinsurer's investments. The market risk control is based on the Value at Risk (VAR) model, which shows the greatest loss expected from an asset or portfolio for a given timeframe and a given likelihood of occurrence.

At December 31, 2016, parametric Value at Risk (VAR) with 95% confidence level, one-business-day timeframe and a 252-business-day history was 0.19% of the portfolio equity.

In line with this control, the Reinsurer has developed a model to calculate the market risk capital based on the principles established in CNSP Ruling No. 321 of July 15, 2015, as amended.

## Austral Resseguradora S.A.

Notes to financial statements (Continued)  
December 31, 2016 and 2015  
(In thousands of reais)

### 5. Reinsurance and financial risk management (Continued)

#### f) Liquidity risk

This refers to the likelihood of a company not being able to honor its payment commitments due to mismatching of deadlines of assets and liabilities. Management has daily visibility of the Reinsurer's portfolio, and regularly discusses the position of investments in its meetings, or on an ad hoc basis, when necessary, considering their liquidity and expected profitability.

The Reinsurer adopts a conservative approach for its financial assets, which is the sum of its cash and cash equivalents plus its financial investments, prioritizing liquidity capacity at all times when choosing its financial assets, based on its obligations to the counterparties.

Currently, 84% of the Company's portfolio (85% at December 31, 2015) correspond to bank deposits, Financial Treasury Bills (LFTs), National Treasury Bills (LTN) and National Treasury Notes (NTN-B) which have daily liquidity regardless of maturity. In addition, 8% (6% at December 31, 2015) of financial assets are represented by other investment funds redeemable within 120 days.

We point out that the Reinsurer links assets accepted by the National Monetary Council to guarantee the need to cover technical reserves and 20% of risk capital, maintaining a liquidity position in relation to risk capital, as set forth in CNSP Ruling No. 321 of July 15, 2015.

Assets and liabilities	December 31, 2016				Total
	No maturity	Within 1 year	From 1 to 2 years	Above 2 years	
Cash and banks	34,699	-	-	-	34,699
Financial assets measured at fair value through profit or loss	60,398	26,423	116,655	100,663	304,139
Financial assets available for sale	-	-	3,932	34,420	38,352
Receivables from reinsurance operations	-	254,699	13,908	-	268,607
Securities and credits receivable	-	14,453	-	-	14,453
<b>Total assets</b>	<b>95,097</b>	<b>295,575</b>	<b>134,495</b>	<b>135,083</b>	<b>660,250</b>
Accounts payable	-	7,186	7,330	-	14,516
Technical reserves - reinsurers (net of retrocession)	-	210,894	11,555	-	222,449
Third-party deposits	-	143	-	-	143
Payables from reinsurance operations	-	133,244	13,019	-	146,263
<b>Total liabilities</b>	<b>-</b>	<b>351,467</b>	<b>31,904</b>	<b>-</b>	<b>383,371</b>

## Austral Resseguradora S.A.

Notes to financial statements (Continued)  
December 31, 2016 and 2015  
(In thousands of reais)

### 5. Reinsurance and financial risk management (Continued)

#### f) Liquidity risk (Continued)

Assets and liabilities	December 31, 2015				Total
	No maturity	Within 1 year	From 1 to 2 years	Above 2 years	
Cash and banks	27,059	-	-	-	27,059
Financial assets measured at fair value through profit or loss	51,112	-	47,149	177,000	275,261
Financial assets available for sale	-	-	-	47,622	47,622
Receivables from reinsurance operations	-	251,351	20,209	-	271,560
Securities and credits receivable	-	12,912	-	-	12,912
<b>Total assets</b>	<b>78,171</b>	<b>264,263</b>	<b>67,358</b>	<b>224,622</b>	<b>634,414</b>
Accounts payable	-	9,566	-	-	9,566
Technical reserves - reinsurers (net of retrocession)	-	197,724	9,184	-	206,908
Third-party deposits	-	256	-	-	256
Payables from reinsurance operations	-	133,231	18,934	-	152,165
<b>Total liabilities</b>	<b>-</b>	<b>340,777</b>	<b>28,118</b>	<b>-</b>	<b>368,895</b>

### 6. Financial assets

#### a) Classification by category and range of maturity

	Rates contracted	December 31, 2016			Book/market value	Curve value	Investment book value percentage	Investment curve percentage	
		No maturity	Within 12 months	From 13 to 60 months					Above 60 months
I. Securities measured at fair value through profit or loss									
Financial Treasury Bills (LFT)	SELIC	-	26,423	165,967	-	192,390	192,430	56%	56%
National Treasury Notes (NTN-B)	IPCA	-	-	-	51,351	51,351	50,107	15%	15%
Investment fund shares		60,398	-	-	-	60,398	60,398	18%	18%
II. Securities available for sale:									
National Treasury Notes (NTN-B)	IPCA	-	-	3,932	34,420	38,352	38,523	11%	11%
<b>Total</b>		<b>60,398</b>	<b>26,423</b>	<b>169,899</b>	<b>85,771</b>	<b>342,491</b>	<b>341,458</b>	<b>100%</b>	<b>100%</b>

	Rates contracted	December 31, 2015			Book market value	Curve value	Investment book value percentage	Investment curve percentage	
		No maturity	Within 12 months	From 13 to 60 months					Above 60 months
I. Securities measured at fair value through profit or loss									
Financial Treasury Bills (LFT)	SELIC	-	-	201,864	-	201,864	201,881	63%	62%
National Treasury Bills (LTN)	Fixed	-	-	22,285	-	22,285	22,737	7%	7%
Investment fund shares		51,112	-	-	-	51,112	51,112	16%	16%
II. Securities available for sale:									
National Treasury Notes (NTN-B)	IPCA	-	-	3,610	44,012	47,622	51,890	15%	16%
<b>Total</b>		<b>51,112</b>	<b>-</b>	<b>227,759</b>	<b>44,012</b>	<b>322,883</b>	<b>327,620</b>	<b>100%</b>	<b>100%</b>

The market values of government securities were determined based on the information disclosed by ANBIMA.

## Austral Resseguradora S.A.

Notes to financial statements (Continued)  
December 31, 2016 and 2015  
(In thousands of reais)

### 6. Financial assets (Continued)

#### a) Classification by category and range of maturity (Continued)

The investment fund shares are valued in view of the unit value of the share at the balance sheet date, as reported by each fund administrator.

The market value of publicly-traded company shares and of listed real estate funds that the Reinsurer has in its portfolio was obtained from the price disclosed by the administrator.

#### b) Fair value hierarchy

The table below presents financial instruments recorded at fair value and their respective assessment methods. The different levels were defined as follows:

- Level 1: securities traded in an active market;
- Level 2: securities not traded in markets covered by "Level 1" whose pricing is directly or indirectly observable.

	December 31, 2016			December 31, 2015		
	Level 1	Level 2	Total	Level 1	Level 2	Total
I. Trading securities						
Investment funds:						
Investment fund shares	-	60,398	60,398	4,924	46,188	51,112
Fixed-income securities - government						
Financial Treasury Bills (LFT)	192,390	-	192,390	201,864	-	201,864
National Treasury Bills (LTN)	-	-	-	22,285	-	22,285
National Treasury Notes (NTN-B)	51,351	-	51,351	-	-	-
II. Securities available for sale						
Fixed-income securities - government						
National Treasury Notes (NTN-B)	38,352	-	38,352	47,622	-	47,622
Total	282,093	60,398	342,491	276,695	46,188	322,883

At December 31, 2016, the Company held 2,893 (3,310 at December 31, 2015) Financial Treasury Bills (LFT), totaling R\$24,420 (R\$21,421 at December 31, 2015), at Banco Itaú S.A. as a collateral to a letter of credit.



## Austral Resseguradora S.A.

Notes to financial statements (Continued)  
December 31, 2016 and 2015  
(In thousands of reais)

### 6. Financial assets (Continued)

#### c) Changes in short-term investments

Changes in short-term investments are stated as follows:

	Fair value through profit or loss	Available for sale	Total
Final balances at December 31, 2014	233,939	44,717	278,656
(+) Investments	219,494	2,482	221,976
(-) Redemptions	(210,724)	(2,812)	(213,536)
(+) Yields	29,670	7,778	37,448
(+/-) Fair value adjustment	2,883	(4,544)	(1,661)
Final balances at December 31, 2015	275,262	47,621	322,883
(+) Investments	75,177	66,835	142,012
(-) Redemptions	(134,696)	(38,421)	(173,117)
(+/-) Transfer of classification	51,351	(51,351)	-
(+) Yields	29,253	9,571	37,579
(+/-) Fair value adjustment	7,792	4,097	13,134
Final balances at December 31, 2016	304,139	38,352	342,491

## Austral Resseguradora S.A.

Notes to financial statements (Continued)  
December 31, 2016 and 2015  
(In thousands of reais)

### 7. Guarantee of technical reserves

The Central Bank of Brazil (BACEN) through Resolution No. 4444 of November 13, 2005, as amended, and SUSEP through CNSP Ruling No. 321 of July 15, 2015, set the standards for investment of the assets to guarantee the technical reserves by local reinsurers. At December 31, 2016 and 2015, the Company's coverage was as follows:

	<b>12/31/2016</b>	<b>12/31/2015</b>
Unearned Premium Reserve (PPNG)	<b>179,122</b>	174,908
Outstanding Claims Reserve (PSL)	<b>156,357</b>	128,823
Incurred But Not Reported Claims Reserve (IBNR)	<b>80,987</b>	72,821
Technical Excess Earnings Reserve (PET)	<b>7,542</b>	6,337
<b>Total technical reserves</b>	<b>424,008</b>	382,889
Credit rights	<b>(101,457)</b>	(84,572)
Deferred brokerage - PPNG reducing account	<b>(870)</b>	(1,137)
Recovery of incurred but not reported claims reserve (IBNR)	<b>(15,849)</b>	(14,270)
Recovery of outstanding claims reserve (PSL)	<b>(76,104)</b>	(47,856)
Unearned premium reserve - retrocession	<b>(41,941)</b>	(51,717)
Technical Excess Earnings Reserve (PET)	<b>(2,415)</b>	(2,725)
<b>Total exclusions</b>	<b>(238,636)</b>	(202,277)
<b>Total technical reserves for coverage</b>	<b>185,372</b>	180,612
Breakdown of assets linked to the coverage of technical reserves		
Financial Treasury Bills (LFT)	<b>131,388</b>	119,533
National Treasury Notes (NTN)	<b>82,020</b>	47,622
National Treasury Bills (LTN)	<b>-</b>	22,285
Investment fund shares	<b>34,740</b>	33,097
<b>Total assets linked to the coverage of technical reserves</b>	<b>248,148</b>	222,537
<b>Sufficiency</b>	<b>62,776</b>	41,925

## Austral Resseguradora S.A.

Notes to financial statements (Continued)  
December 31, 2016 and 2015  
(In thousands of reais)

### 8. Receivables from reinsurance operations

	<u>12/31/2016</u>	<u>12/31/2015</u>
Premiums receivable - current	<b>238,652</b>	223,746
Premiums receivable - noncurrent	<b>13,908</b>	20,209
Total current and noncurrent	<b>252,560</b>	243,955
Aging of premiums receivable		
Premiums falling due		
From 1 to 30 days	<b>16,745</b>	40,335
From 31 to 60 days	<b>15,056</b>	11,682
From 61 to 120 days	<b>10,109</b>	4,934
From 121 to 180 days	<b>8,397</b>	48,255
From 181 to 360 days	<b>185,398</b>	107,717
Above 360 days	<b>13,908</b>	20,209
Total premiums falling due	<b>249,613</b>	233,132
Overdue premiums		
From 1 to 30 days	<b>1,072</b>	7,961
From 31 to 60 days	<b>1,875</b>	2,862
Total overdue premiums	<b>2,947</b>	10,823
Total premiums receivable	<b>252,560</b>	243,955
Recovery of brokerage fees	<b>3</b>	-
Recovery of claims effectively paid	<b>5,739</b>	17,948
Profit sharing receivable	<b>9,200</b>	9,623
Other receivables	<b>1,105</b>	34
Other receivables from operations	<b>16,047</b>	27,605
Total current	<b>254,699</b>	251,351
Total noncurrent	<b>13,908</b>	20,209
Total receivables from operations	<b>268,607</b>	271,560
Changes in premiums receivable		
Opening balance	<b>243,955</b>	242,271
(+) Written Premiums	<b>439,959</b>	484,948
(-) Receivables	<b>(431,354)</b>	(483,264)
Closing balance	<b>252,560</b>	243,955

## Austral Resseguradora S.A.

Notes to financial statements (Continued)  
December 31, 2016 and 2015  
(In thousands of reais)

### 9. Retrocession assets

	12/31/2016	12/31/2015
Incurred but not reported claims reserve (IBNR)	15,849	14,270
Outstanding claims reserve	76,104	47,856
Unearned premium reserve	107,191	111,130
Other reserves	2,415	2,725
Total current	175,355	140,557
Total noncurrent	26,204	35,424
Overall total	201,559	175,981

### 10. Tax credits

At December 31, 2016, the amount of R\$11,936 (R\$11,040 at December 31, 2015) refers to: (i) R\$6,761 (R\$6,488 at December 31, 2015) refers to tax credits from Contribution Taxes on Gross Revenue for Social Integration Program (PIS) and for Social Security Financing (COFINS) calculated on the balance of the outstanding claims reserve (PSL) and the incurred but not reported claims reserve (IBNR); and (ii) R\$5,175 (R\$4,552 at December 31, 2015) referring to tax credits from Corporate Income Tax (IRPJ) and Social Contribution Tax on Net Profit (CSLL).

### 11. Deferred brokerage

Group	12/31/2015	Set up	Amortization	12/31/2016
Property	3,002	748	(1,147)	2,603
Aviation	700	579	(725)	554
Special risks	365	200	(449)	116
Liabilities	161	123	(79)	205
Motor	68	179	(37)	210
Marine	68	79	(53)	94
Transportation	378	8	(245)	141
Financial risks	24	114	(15)	123
Life - Group	267	432	(379)	320
Agro	106	78	(37)	147
Other	302	431	(468)	265
Total current and noncurrent	5,441	2,971	(3,634)	4,778

## Austral Resseguradora S.A.

Notes to financial statements (Continued)  
December 31, 2016 and 2015  
(In thousands of reais)

### 11. Deferred brokerage (Continued)

Group	12/31/2014	Set up	Amortization	12/31/2015
Property	1,996	1,980	(974)	3,002
Aviation	444	637	(381)	700
Special risks	148	686	(469)	365
Liabilities	160	55	(54)	161
Motor	173	11	(116)	68
Marine	45	43	(20)	68
Transportation	519	50	(191)	378
Financial risks	49	13	(38)	24
Life - Group	246	322	(301)	267
Agro	125	134	(153)	106
Other	270	397	(365)	302
Total current and noncurrent	4,175	4,328	(3,062)	5,441

The above mentioned deferred brokerage refers to total brokerage expenses, which are recorded upon acceptance of the contracts and allocated to P&L in accordance with the coverage period elapsed. These brokerages are deferred through the same methodology used for premium deferral. All deferred brokerage expenses were taken into consideration in the liability adequacy test.

### 12. Property and equipment

	Annual depreciation rate	12/31/2015	Acquisitions	Write-off	Depreciation	12/31/2016
IT equipment	20%	205	10	-	(88)	127
Telecommunication systems	10%	61	-	-	(12)	49
Furniture, machinery and fixtures	10%	104	-	-	(19)	85
Air-conditioning and security systems	10%	20	-	-	(4)	16
Facilities	10%	-	241	-	(21)	220
Total		390	251	-	(144)	497

	Annual depreciation rate	12/31/2014	Acquisitions	Write-off	Depreciation	12/31/2015
IT equipment	20%	346	7	-	(148)	205
Telecommunication systems	10%	73	-	-	(12)	61
Furniture, machinery and fixtures	10%	274	2	(132)	(40)	104
Air-conditioning and security systems	10%	153	-	(112)	(21)	20
Facilities	10%	441	-	(379)	(62)	-
Total		1,287	9	(623)	(283)	390

## Austral Resseguradora S.A.

Notes to financial statements (Continued)  
December 31, 2016 and 2015  
(In thousands of reais)

### 13. Intangible assets

	Annual amortization rate	12/31/2015	Acquisitions	Amortization	12/31/2016
Right to use third-party software	20%	669	3	(251)	421
Total		<b>669</b>	<b>3</b>	<b>(251)</b>	<b>421</b>

	Annual amortization rate	12/31/2014	Acquisitions	Amortization	12/31/2015
Right to use third-party software	20%	784	270	(385)	669
Total		<b>784</b>	<b>270</b>	<b>(385)</b>	<b>669</b>

### 14. Operations with reinsurers

	12/31/2016	12/31/2015
Ceded retrocession premiums	<b>154,006</b>	166,193
Commission	<b>(31,160)</b>	(42,353)
Other	<b>40</b>	52
Total current	<b>122,886</b>	123,892
Ceded retrocession premiums	<b>21,724</b>	30,689
Commission	<b>(8,720)</b>	(11,755)
Total noncurrent	<b>13,004</b>	18,934
Total	<b>135,890</b>	142,826

# Austral Resseguradora S.A.

Notes to financial statements (Continued)  
December 31, 2016 and 2015  
(In thousands of reais)

## 15. Reinsurance contract liabilities

	Reinsurance reserve		Retrocession portion		Reinsurance (-) retrocession = net reserve	
	12/31/2016	12/31/2015	12/31/2016	12/31/2015	12/31/2016	12/31/2015
Property	37,497	36,696	(20,640)	(19,534)	16,857	17,162
Special risks	4,078	6,627	(2,853)	(3,736)	1,225	2,891
Liabilities	8,312	3,603	(5,742)	(1,359)	2,570	2,244
Motor	14,652	2,168	(13)	(3)	14,639	2,165
Transportation	15,121	10,583	(13,249)	(5,215)	1,872	5,368
Financial risks	54,528	74,135	(48,833)	(70,416)	5,695	3,719
Life - Group	11,387	14,534	(6,758)	(4,845)	4,629	9,689
Agro	6,570	5,529	(335)	(349)	6,235	5,180
Other	16,021	12,286	(527)	(200)	15,494	12,086
Marine	4,639	3,378	(3,937)	(2,785)	702	593
Aviation	6,317	5,369	(4,304)	(2,688)	2,013	2,681
<b>Unearned Premium Reserve (PPNG)</b>	<b>179,122</b>	<b>174,908</b>	<b>(107,191)</b>	<b>(111,130)</b>	<b>71,931</b>	<b>63,778</b>
Property	74,123	67,869	(41,331)	(34,310)	32,792	33,559
Special risks	159	519	(5)	(6)	154	513
Liabilities	1,914	1,001	(70)	-	1,844	1,001
Motor	7,690	5,243	(194)	(57)	7,496	5,186
Transportation	25,395	12,991	(14,366)	(2,720)	11,029	10,271
Financial risks	8,266	5,755	(6,820)	(4,980)	1,446	775
Life - Group	17,744	16,147	(6,169)	(4,331)	11,575	11,816
Life - individual	8	3	-	-	8	3
Agro	2,502	10,094	(826)	(478)	1,676	9,616
Other	11,616	5,573	(575)	(92)	11,041	5,481
Marine	3,496	1,757	(3,104)	(607)	392	1,150
Aviation	3,444	1,871	(2,644)	(275)	800	1,596
<b>Outstanding claims reserve (PSL)</b>	<b>156,357</b>	<b>128,823</b>	<b>(76,104)</b>	<b>(47,856)</b>	<b>80,253</b>	<b>80,967</b>
Property	8,519	7,717	(5,033)	(2,645)	3,486	5,072
Special risks	308	610	(196)	(347)	112	263
Liabilities	855	494	(456)	(162)	399	332
Motor	16,018	15,920	(33)	(409)	15,985	15,511
Transportation	10,069	3,947	(1,690)	(868)	8,379	3,079
Financial risks	476	429	(407)	(361)	69	68
Life - Group	7,695	12,915	(2,185)	(3,135)	5,510	9,780
Life - individual	22	4	(7)	(1)	15	3
Agro	6,680	5,900	(2,750)	(4,414)	3,930	1,486
Other	26,965	21,974	(143)	(27)	26,822	21,947
Marine	436	387	(384)	(323)	52	64
Aviation	2,944	2,524	(2,565)	(1,578)	379	946
<b>Incurred But Not Reported Claims Reserve (IBNR)</b>	<b>80,987</b>	<b>72,821</b>	<b>(15,849)</b>	<b>(14,270)</b>	<b>65,138</b>	<b>58,551</b>
Property	623	497	(199)	(140)	424	357
Special risks	4	4	(3)	(3)	1	1
Liabilities	110	40	(1)	(1)	109	39
Motor	2,320	37	(11)	(11)	2,309	26
Transportation	67	186	(27)	(12)	40	174
Financial risks	2,217	2,491	(2,113)	(2,450)	104	41
Life - Group	471	481	(55)	(18)	416	463
Agro	5	881	(2)	(87)	3	794
Other	1,685	1,693	-	-	1,685	1,693
Marine	9	8	(3)	(3)	6	5
Aviation	31	19	(1)	-	30	19
<b>Technical Excess Earnings Reserve (PET)</b>	<b>7,542</b>	<b>6,337</b>	<b>(2,415)</b>	<b>(2,725)</b>	<b>5,127</b>	<b>3,612</b>
Total current	386,249	338,281	(175,355)	(140,557)	210,894	197,724
Total noncurrent	37,759	44,608	(26,204)	(35,424)	11,555	9,184
Overall total	424,008	382,889	(201,559)	(175,981)	222,449	206,908

# Austral Resseguradora S.A.

Notes to financial statements (Continued)  
December 31, 2016 and 2015  
(In thousands of reais)

## 15. Reinsurance contract liabilities (Continued)

Changes in technical reserves are stated as follows:

	12/31/2016			12/31/2015		
	Reinsurance	Retrocession	Net	Reinsurance	Retrocession	Net
Outstanding claims reserve (PSL)	156,357	(76,104)	80,253	128,823	(47,856)	80,967
Incurred But Not Reported Claims Reserve (IBNR)	80,987	(15,849)	65,138	72,821	(14,270)	58,551
<b>Total claims reserve</b>	<b>237,344</b>	<b>(91,953)</b>	<b>145,391</b>	<b>201,644</b>	<b>(62,126)</b>	<b>139,518</b>
Unearned Premium Reserve (PPNG)	179,122	(107,191)	71,931	174,908	(111,130)	63,778
Technical Excess Earnings Reserve (PET)	7,542	(2,415)	5,127	6,337	(2,725)	3,612
<b>Total premium reserve</b>	<b>186,664</b>	<b>(109,606)</b>	<b>77,058</b>	<b>181,245</b>	<b>(113,855)</b>	<b>67,390</b>
<b>Total</b>	<b>424,008</b>	<b>(201,559)</b>	<b>222,449</b>	<b>382,889</b>	<b>(175,981)</b>	<b>206,908</b>
Progress of reserves for claims						
At January 1	201,644	(62,126)	139,518	146,208	(44,853)	101,355
Claims incurred in the period	298,713	(61,275)	237,438	313,265	(141,246)	172,019
Claims paid in the period	(260,023)	30,896	(229,127)	(261,673)	124,604	(137,069)
Related expenses paid	(83)	24	(59)	-	-	-
Salvages and reimbursement paid	35	-	35	-	-	-
Foreign exchange variation	(3,717)	760	(2,957)	3,037	(465)	2,572
Monetary restatement	775	(232)	543	-	-	-
<b>At the end of the year</b>	<b>237,344</b>	<b>(91,953)</b>	<b>145,391</b>	<b>201,644</b>	<b>(62,126)</b>	<b>139,518</b>
Progress of premium reserves						
At January 1	181,245	(113,855)	67,390	179,275	(106,888)	72,387
Written premiums in the period	401,939	(136,797)	265,142	467,869	(163,136)	304,733
Earned premiums in the period	(394,166)	139,776	(254,390)	(466,267)	157,100	(309,167)
Foreign exchange variation	(2,354)	1,270	(1,084)	368	(931)	(563)
<b>At the end of the year</b>	<b>186,664</b>	<b>(109,606)</b>	<b>77,058</b>	<b>181,245</b>	<b>(113,855)</b>	<b>67,390</b>
Progress of PSL reserve						
At January 1	128,823	(47,856)	80,967	80,527	(27,881)	52,646
Changes	27,534	(28,248)	(714)	48,296	(19,975)	28,321
<b>At the end of the year</b>	<b>156,357</b>	<b>(76,104)</b>	<b>80,253</b>	<b>128,823</b>	<b>(47,856)</b>	<b>80,967</b>
Progress of IBNR reserve						
At January 1	72,821	(14,270)	58,551	65,665	(16,972)	48,693
Changes	8,166	(1,579)	6,587	7,156	2,702	9,858
<b>At the end of the year</b>	<b>80,987</b>	<b>(15,849)</b>	<b>65,138</b>	<b>72,821</b>	<b>(14,270)</b>	<b>58,551</b>
Progress of PDR reserve						
At January 1	-	-	-	15	-	15
Changes	-	-	-	(15)	-	(15)
<b>At the end of the year</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>



## Austral Resseguradora S.A.

Notes to financial statements (Continued)  
December 31, 2016 and 2015  
(In thousands of reais)

### 16. Progress of claims

Due to the peculiarities of reinsurance operations, in automatic treaties the Company does not have detailed information of each claim with individual progress of its value in time. As such, the claim amount reported varies as updated information is obtained through bordereau sent by cedents on the underwritten contracts.

The progress of claims reported to Austral Resseguradora per underwriting year, as well as payments of claims and restatement of legal claims for each year are stated below. Under this analysis, the underwritten contracts in US dollars were translated at the exchange rate as of December 31, 2016 at R\$3.2591.

#### Progress of reinsurance claims reported

Underwriting year	Reported claim period						Total
	0	1	2	3	4	5	
2011	730	72,729	23,366	1,541	32	794	99,192
2012	7,586	104,510	36,153	11,564	2,230	-	162,043
2013	6,758	76,197	23,980	10,151	-	-	117,086
2014	76,223	173,111	25,983	-	-	-	275,317
2015	95,455	86,041	-	-	-	-	181,496
2016	164,589	-	-	-	-	-	164,589
Total	<u>351,341</u>	<u>512,588</u>	<u>109,482</u>	<u>23,256</u>	<u>2,262</u>	<u>794</u>	<u>999,723</u>

In	2011	2012	2013	2014	2015	2016	Total
Interest - Court level	-	-	-	-	694	775	1,469

In	2011	2012	2013	2014	2015	2016	Total
Payments	287	59,911	79,466	184,344	261,380	259,447	844,835
PSL	351,054	452,677	30,016	(161,088)	(258,424)	(257,878)	156,357

## Austral Resseguradora S.A.

Notes to financial statements (Continued)  
December 31, 2016 and 2015  
(In thousands of reais)

### 16. Progress of claims (Continued)

#### Progress of retrocession claims reported

Underwriting year	Reported claim period						Total
	0	1	2	3	4	5	
2011	91	55,955	12,382	813	(350)	(236)	<b>68,655</b>
2012	741	51,372	6,925	58	(299)	-	<b>58,797</b>
2013	11,916	43,301	8,278	3,049	-	-	<b>66,544</b>
2014	68,230	117,992	8,283	-	-	-	<b>194,505</b>
2015	17,737	36,721	-	-	-	-	<b>54,458</b>
2016	11,870	-	-	-	-	-	<b>11,870</b>
Total	110,585	305,341	35,868	3,920	(649)	(236)	<b>454,829</b>

In	2011	2012	2013	2014	2015	2016	Total
Interest - Court level	-	-	-	-	206	231	<b>437</b>

In	2011	2012	2013	2014	2015	2016	Total
Payments	1	49,768	46,577	127,599	116,525	38,692	<b>379,162</b>
PSL	-	-	-	-	-	-	<b>76,104</b>

## Austral Resseguradora S.A.

Notes to financial statements (Continued)  
December 31, 2016 and 2015  
(In thousands of reais)

### 16. Progress of claims (Continued)

#### Progress of net claims reported

Underwriting year	Reported claim period						Total
	0	1	2	3	4	5	
2011	639	16,773	10,984	728	382	1,030	30,537
2012	6,845	53,139	29,227	11,505	2,529	-	103,246
2013	(5,158)	32,896	15,702	7,103	-	-	50,542
2014	7,993	55,118	17,701	-	-	-	80,812
2015	77,718	49,322	-	-	-	-	127,039
2016	152,719	-	-	-	-	-	152,719
Total	240,756	207,248	73,614	19,336	2,911	1,030	544,895

In	2011	2012	2013	2014	2015	2016	Total
Interest – Court level	-	-	-	-	488	543	1,031

In	2011	2012	2013	2014	2015	2016	Total
Payments	286	10,143	32,889	56,745	144,855	220,755	465,673
PSL	-	-	-	-	-	-	80,253

### 17. Equity

#### a) Capital

At December 31, 2016 and 2015, subscribed and paid-in capital comprises 211,100,409 common registered shares, with no par value.

At the General Shareholder's Meeting held on December 30, 2015, the shareholders approved a capital increase through subscription in kind amounting to R\$10,700, by issuing 8,425,070 new common registered shares with no par value, at issue price of R\$1.27 (in reais) per share, based on the unit issue price. Accordingly, capital amounting to R\$209,479 increased to R\$220,179, and the number of shares from 202,675,339 to 211,100,409 common registered shares with no par value. This capital increase was approved by SUSEP/DIRAT Administrative Ruling No. 1.314 of February 24, 2016.

#### b) Income reserves

Income reserves comprise the legal reserve set up at 5% of income for the year after absorption of accumulated losses, and the remaining amount is allocated to the retained profits reserve.

## Austral Resseguradora S.A.

Notes to financial statements (Continued)  
December 31, 2016 and 2015  
(In thousands of reais)

### 17. Equity (Continued)

c) Mandatory minimum dividends and interest on equity

The Company's Articles of Incorporation establishes a minimum dividend of 25%, calculated on annual net income, adjusted in accordance with article 202 of Law No. 6.404/76.

For the years ended December 31, 2016 and 2015, as approved by shareholders at a Special General Meeting and after the recognition of a legal reserve, dividends were paid out to shareholders in the form of interest on equity, as follows:

	<u>12/31/2016</u>	<u>12/31/2015</u>
Net income for the year	<b>33,789</b>	43,257
Allocation to legal reserve	<b>(1,690)</b>	(2,163)
Tax base	<b>32,099</b>	41,094
Mandatory minimum dividends - 25%	<b>8,025</b>	10,274
Interest on equity credited to replace minimum dividends (*)	<b>(20,165)</b>	(14,308)
Interest on equity in addition to mandatory minimum dividends	<b>12,140</b>	4,035

(\*) As permitted by Law No. 9249/95, for the years ended December 31, 2016 and 2015, the Company credited interest on equity within tax limits, in the amount of R\$20,165 (R\$17,140, net of withholding income tax) and in the amount of R\$14,308 (R\$12,162, net of withholding income tax) respectively, to its shareholders. Interest on equity is recorded as a financial expense and is stated in equity as profit sharing in the financial statements.

## Austral Resseguradora S.A.

Notes to financial statements (Continued)  
December 31, 2016 and 2015  
(In thousands of reais)

### 17. Equity (Continued)

d) Breakdown of adjusted equity (PLA) and capital requirement

	<u>12/31/2016</u>	<u>12/31/2015</u>
Equity	<b>282,575</b>	266,387
Intangible assets	<b>(421)</b>	(669)
Increase in surplus among reserves recorded	<b>1,818</b>	-
Adjusted equity (PLA)	<b>283,972</b>	265,718
Basis Capital (BC) (a)	<b>60,000</b>	60,000
Additional capital - underwriting risk (CRSub)	<b>66,798</b>	53,257
Additional capital - credit risk (CRCr)	<b>16,624</b>	14,569
Additional capital - market risk (CRMerc)	<b>5,912</b>	-
Additional capital - operational risk (CROp)	<b>2,641</b>	4,058
Diversification benefit	<b>(11,038)</b>	(5,984)
Risk capital (CR) (b)	<b>80,937</b>	65,900
Minimum required capital (MRC) the highest of (a) and (b)	<b>80,937</b>	65,900
Adjusted equity	<b>283,972</b>	265,718
(-) Capital requirement (CR)	<b>80,937</b>	65,900
Capital sufficiency - R\$	<b>203,035</b>	199,818
Capital sufficiency (% of CR)	<b>251.00%</b>	303.21%

CNSP Ruling No. 321 of December 15, 2015 sets forth that minimum required capital that the overseen entity shall keep at any time to operate is the highest of base capital and risk capital.

The Reinsurer is compliant with the change in the adjusted equity formula defined by CNSP Ruling No. 343 of December 26, 2016.

## Austral Resseguradora S.A.

Notes to financial statements (Continued)  
December 31, 2016 and 2015  
(In thousands of reais)

### 18. Income and social contributions taxes

Income and social contribution taxes calculated at the effective official rates at December 31, 2016 and 2015 are reconciled as follows:

	12/31/2016		12/31/2015	
	Income tax	Social contribution tax	Income tax	Social contribution tax
Income (loss) before income taxes and profit sharing	44,973	44,973	67,995	67,995
Statutory profit sharing	(2,421)	(2,421)	(4,176)	(4,176)
Interest on equity	(20,165)	(20,165)	(14,308)	(14,308)
Tax base	22,387	22,387	49,511	49,511
Total IRPJ and CSLL at statutory rates	(5,597)	(4,477)	(12,378)	(7,427)
Other permanent (additions) exclusions	1,139	(50)	(32)	(19)
Permanent (additions) exclusions in the tax calculation	1,139	(50)	(32)	(19)
Foreign exchange variation	(2,345)	(1,876)	1,029	618
Market value adjustment	2,241	1,793	706	422
Other reserves	(9)	(8)	1,456	874
Temporary (additions) exclusions in the tax calculation	(113)	(91)	3,191	1,914
Tax deductions	280	-	179	-
Increase in CSLL rate (2015)	-	-	-	(139)
Income and social contribution tax expenses	(4,291)	(4,618)	(9,040)	(5,671)
Deferred tax revenue (expenses)	113	32	(3,022)	(2,829)
Total revenue (expense)	(4,178)	(4,586)	(12,062)	(8,500)

On May 21, 2015, Provisional Executive Order (MP) No. 675/15 was published, which increased the Social Contribution Tax on Net Profit (CSLL) rate of financial and insurance institutions from 15% to 20% of taxable profit, effective from September 1, 2015 onwards. On October 7, 2015, Law No. 13169 was published, which reduces such rate from 20% to 15% from 2019 onwards.

## Austral Resseguradora S.A.

Notes to financial statements (Continued)  
December 31, 2016 and 2015  
(In thousands of reais)

### 19. Transactions with related parties

The Company engages in transactions with related parties of Grupo Vinci Partners Ltda. and International Finance Corporation (IFC). The main transactions with these companies comprise the investment portfolio management, whose amounts are recorded under financial expenses, issue of reinsurance contracts, whose amounts are recorded under written premiums, technical reserves, incurred claims and operating income (expenses). Also, the Company and Austral Seguradora S.A. rationalize their costs by sharing administrative expenses in common, recorded as administrative expenses. The transactions are performed under such conditions agreed upon by and between the parties and approved by the Board of Directors.

For the year ended December 31, 2016, the Company recorded no liabilities regarding interest on equity, net of Withholding Income Tax (IRRF), payable to shareholders (R\$8,366 at December 31, 2015).

Throughout the year ended December 31, 2015, the Company compensated its management, represented by statutory officers, amounting to R\$657 (R\$825 at December 31, 2015). Balance sheets and P&L balances arising from transactions with these companies and management members are as follows:

Related parties	Assets		Liabilities		Revenue/Expenses	
	12/31/2016	12/31/2015	12/31/2016	12/31/2015	12/31/2016	12/31/2015
Vinci Gestora de Recursos Ltda.	-	-	40	37	(603)	(401)
Austral Participações S.A.	-	-	-	1,462	(20,165)	(14,308)
Fundo de Invest Imob RM Leblon	-	-	71	60	(1,125)	(444)
Braquiara empreendimentos	-	-	37	31	(398)	(157)
Austral Seguradora S.A.	32,765	40,530	10,485	8,089	24,120	33,814
Management	-	-	-	-	(657)	(825)
Total	32,765	40,530	10,633	9,679	1,172	17,679

## Austral Resseguradora S.A.

Notes to financial statements (Continued)  
December 31, 2016 and 2015  
(In thousands of reais)

### 20. Groups of reinsurance lines

The Company's reinsurance line groups and their performance indicators at December 31, 2016 and 2015 are as follows:

Groups	Earned premiums		Loss ratio - % (a)		Acquisition ratio - % (b)	
	12/31/2016	12/31/2015	12/31/2016	12/31/2015	12/31/2016	12/31/2015
Aviation	9,967	5,433	39.45%	46.99%	10.49%	17.96%
Motor	8,343	10,995	119.71%	83.46%	2.54%	2.33%
Other	121,322	115,653	140.41%	125.98%	1.74%	2.20%
Property	67,936	50,474	58.43%	100.37%	6.13%	7.34%
Life - Group	70,922	158,423	27.69%	20.41%	0.94%	0.42%
Life - individual	-	47	0.00%	(19.85%)	0.00%	-
Special risks	5,371	6,312	(4.84)%	6.66%	3.50%	4.58%
Liabilities	12,732	3,540	16.07%	28.83%	2.92%	5.82%
Financial risks	43,199	42,720	6.86%	14.68%	0.11%	0.14%
Agro	21,753	52,847	73.37%	94.46%	1.91%	0.63%
Marine	6,278	3,597	38.29%	47.30%	1.94%	2.96%
Transportation	26,343	16,226	121.34%	83.33%	2.11%	3.60%
Total	394,166	466,267				

Groups	Net earned premiums		Net loss ratio - % (a)	
	12/31/2016	12/31/2015	12/31/2016	12/31/2015
Aviation	3,094	3,431	9.25%	41.71%
Motor	8,540	10,665	119.15%	82.90%
Other	120,562	88,575	140.50%	100.73%
Property	25,826	21,453	71.24%	126.18%
Life - Group	54,060	149,498	15.73%	14.73%
Life - individual	-	28	0.00%	14.42%
Special risks	1,954	1,422	(5.58)%	45.00%
Liabilities	4,604	2,757	29.89%	31.85%
Financial risks	2,050	2,279	39.79%	39.65%
Agro	22,644	18,539	68.83%	68.58%
Marine	977	795	(44.57)%	108.40%
Transportation	10,079	9,725	133.21%	76.44%
Total	254,390	309,167		

(a) The loss ratio = (reported indemnities + claim expenses + change in the Incurred But Not Reported Claims Reserve (IBNR))/Earned premium.

(b) Acquisition ratio = earned acquisition cost/earned premium.



## Austral Resseguradora S.A.

Notes to financial statements (Continued)  
December 31, 2016 and 2015  
(In thousands of reais)

### 20. Groups of reinsurance lines (Continued)

The accepted reinsurance and retrocession premiums (net premium written) before and after ceded retrocession premiums are broken down below for the years ended December 31, 2016 and 2015.

Groups	Gross written premium (-)									
	Gross written premium		Ceded retrocession premium		retrocession = net premium		% - Retention		% - Retrocession	
	12/31/2016	12/31/2015	12/31/2016	12/31/2015	12/31/2016	12/31/2015	12/31/2016	12/31/2015	12/31/2016	12/31/2015
Aviation	11,096	7,886	(8,553)	(3,758)	2,543	4,128	22.91	52.35	77.09	47.65
Motor	23,110	4,872	188	(10)	23,298	4,862	100.81	99.79	(0.81)	0.21
Other	125,301	119,124	(1,087)	(24,682)	124,214	94,442	99.13	79.28	0.87	20.72
Property	69,764	60,282	(43,856)	(37,202)	25,908	23,080	37.14	38.29	62.86	61.71
Life – Group	67,776	156,567	(18,818)	(11,531)	48,958	145,036	72.24	92.64	27.76	7.36
Life - individual	-	43	-	(16)	-	27	-	62.79	-	37.21
Liabilities	17,519	5,370	(12,509)	(1,902)	5,010	3,468	28.60	64.58	71.40	35.42
Financial risks	23,580	43,843	(19,495)	(41,759)	4,085	2,084	17.32	4.75	82.68	95.25
Special risks	3,140	9,018	(2,669)	(5,677)	471	3,341	15	37.05	85	62.95
Agro	21,927	40,315	989	(22,191)	22,916	18,124	104.51	44.96	(4.51)	55.04
Housing	-	-	-	-	-	-	-	-	-	-
Marine	7,589	6,529	(6,464)	(5,398)	1,125	1,131	14.82	17.32	85.18	82.68
Transportation	31,137	14,020	(24,523)	(9,010)	6,614	5,010	21.24	35.73	78.76	64.27
<b>Total</b>	<b>401,939</b>	<b>467,869</b>	<b>(136,797)</b>	<b>(163,136)</b>	<b>265,142</b>	<b>304,733</b>	<b>65.97</b>	<b>65.13</b>	<b>34.03</b>	<b>34.87</b>

Ceded retrocession premiums by class of reinsurers:

	12/31/2016	12/31/2015
Local reinsurer	3,400	34,217
Admitted reinsurer	70,070	94,509
Eventual reinsurer	63,327	34,410
<b>Total</b>	<b>136,797</b>	<b>163,136</b>

Accepted reinsurance and accepted retrocession premiums by class:

	12/31/2016	12/31/2015
Insurance company	374,205	438,917
Local reinsurer	550	12
Admitted reinsurer	26,273	28,940
Eventual reinsurer	911	-
<b>Total</b>	<b>401,939</b>	<b>467,869</b>

### 21. Stock option plan

At the General Shareholder's Meeting held on October 1, 2013, the shareholders approved the first stock option plan of Austral Participações S.A. ("Austral Participações"), the Company's parent company.

## **Austral Resseguradora S.A.**

Notes to financial statements (Continued)  
December 31, 2016 and 2015  
(In thousands of reais)

### **21. Stock option plan (Continued)**

The plan sets forth general conditions for granting by Austral Participações of preferred stock options for shares issued by Austral Participações to eligible professionals, management members and employees of Austral Participações and its affiliates and/or subsidiaries. The granting terms and conditions are defined and managed by the Management Committee, pursuant to the guidelines and conditions established by the stock option plan, and the plan will be settled with Austral Participações' shares, if and when the options are called, at the strike price to be paid by buyers.

The plan management committee may establish different vesting conditions or option term for each plan or individual contract, in order to extend terms and/or its scheduling.

In the meetings held by the stock option plan management committee on October 1 and 2, 2013, the first and second stock option programs were approved, whereby Austral Participações granted stock options to participants, totaling 4,500,000 options.

In the meeting held by the stock option plan management committee on December 19, 2014, the third stock option plan program was approved, whereby Austral Participações granted stock options to participants, totaling 4,832,137 options.

In the meeting held by the stock option plan management committee on April 1, 2016, the fourth stock option plan was approved, whereby Austral Participações granted stock options to participants, totaling 76,616 options.

The first program provides for three vesting dates, the last being December 2014, when the participants will have the right to buy their options for the services provided, for the period of four years as from the last vesting date and as from each of vesting dates established by the plan management committee, subject to the contractual conditions.

The second program provides for four vesting dates, the last being September 2016, when the participants will have the right to buy their options for the services provided, for the period of four years as from the last vesting date and as from each of the vesting dates established by the plan management committee, subject to the contractual conditions.

## **Austral Resseguradora S.A.**

Notes to financial statements (Continued)  
December 31, 2016 and 2015  
(In thousands of reais)

### **21. Stock option plan (Continued)**

The third program defines three to five vesting dates, depending on the participant, the last being September 2018, when the beneficiaries will have the right to buy their options for the services provided, for a period of two years from the last vesting date and from each of the vesting dates established by the plan management committee, subject to the contractual conditions.

The four program provides for three vesting dates, the last being December 2018, when the participants will have the right to buy their options for the services provided, for the period of eighteen months as from the last vesting date and as from each of the vesting dates established by the plan management committee, subject to the contractual conditions.

For the first and second programs, the fair value of options is estimated on the granting date, based on the Monte Carlo simulation model, at a volatility of approximately 27.5%, i.e. in line with volatilities of the insurance industry companies listed in stock exchange at the granting time, and fixed interest rate curve on granting dates, according to the future market of interest rate traded at BM&FBovespa. The spot price was calculated based on Vinci Capital Partners' assumptions, which have been audited by independent auditor over the ordinary course of the auditing process of Fundo Vinci Capital Partners II FIQ FIP. The option strike price of both programs is R\$1.1425, which is restated by an inflation index and by the payment of dividends and interest on equity per share paid by the Company from time to time, as from the date the individual contract is entered into with the participant.

Based on those assumptions, the weighted average fair value of each option granted was R\$0.4922.

For the third program, the fair value of options is estimated on the granting date, based on the Black and Scholes option model, at a volatility of approximately 36.5%, i.e. in line with volatilities for listed insurers at the time of the grant, and the fixed interest rate curve on the granting date according to the future interest rate market traded at BM&FBovespa. The spot price used was the price of first issue of shares for IFC, and the strike price is R\$1.1752, which is restated by an inflation index and by the payment of dividends and interest on equity per share paid by the Company from time to time, as from the date the individual contract is entered into with the participant. Based on those assumptions, the weighted average fair value of each option granted was R\$0.4529.

## **Austral Resseguradora S.A.**

Notes to financial statements (Continued)  
December 31, 2016 and 2015  
(In thousands of reais)

### **21. Stock option plan (Continued)**

For the four program, the options fair value is estimated on the granting date, based on the Black-Scholes model, considering a volatility of approximately 38.2%, in line with the volatilities of the insurance industry companies listed in stock exchanges at the granting time, and the interest rate curve determined on the granting dates, according to the future market of interest rate traded at BM&FBovespa. The spot price used was calculated based on Fundo Vinci Capital Partners II FIQ FIP, and the strike price was R\$1.2171, which is restated by an inflation index and by the payment of dividends and interest on equity per share paid by the Company from time to time, as from the date the individual contract is entered into with the participant. Based on those assumptions, the weighted average fair value of each option granted was R\$0.49.

Austral Participações grants to each participant a put option of its shares (shares acquired through the exercise of the options by the participant), as well as Austral Participações have a call option of such shares (shares acquired through the exercise of the options by the participant). The term and price of such puts and calls options are determined in individual contracts entered into between Austral Participações and the participants.

At the General Shareholder's Meeting held on March 18, 2016, the shareholders approved the second stock option plan of Austral Participações S.A., the Reinsurer's controlling company.

The Second Plan sets forth general conditions for granting by Austral Participações of preferred stock options for shares issued by Austral Participações to eligible professionals, management members and employees of Austral Participações and its affiliates and/or subsidiaries. The granting terms and conditions are defined and managed by the Management Committee, pursuant to the guidelines and conditions established by the Stock Option Plan, and the Plan will be settled with Austral Participações' shares, if and when the options are called, upon payment at strike price to be performed by buyers.

The plan management committee may establish different vesting conditions or option term for each plan or individual contract, in order to extend terms and/or its scheduling.

In the meeting held by the stock option plan management committee on April 1, 2016, the first stock option program of second plan was approved, whereby Austral Participações granted stock options to participants totaling 1,884,307 options.

## Austral Resseguradora S.A.

Notes to financial statements (Continued)  
December 31, 2016 and 2015  
(In thousands of reais)

### 21. Stock option plan (Continued)

For the first program of the second plan, the options fair value is estimated on the granting date, based on the Black-Scholes model, considering a volatility of approximately 38.2%, in line with the volatilities of the insurance industry companies listed in stock exchanges at the granting time, and the interest rate curve determined on the granting dates, according to the future market of interest rate traded at BM&FBovespa. The spot price used was calculated based on Fundo Vinci Capital Partners II FIQ FIP, and the strike price was R\$2.8316, which is restated by an inflation index and by the payment of dividends and interest on equity per share paid by the Company from time to time, as from the date the individual contract is entered into with the participant. Based on those assumptions, the weighted average fair value of each option granted was R\$0.25.

In the meeting held by the stock option plan management committee on September 5, 2016, the second stock option program of second plan was approved, whereby Austral Participações granted stock options to participants totaling 75,748 options.

For the second program of the second plan, the options fair value is estimated on the granting date, based on the Black-Scholes model, considering a volatility of approximately 38.2%. The spot price used was calculated based on Fundo Vinci Capital Partners II FIQ FIP, and the strike price is R\$2.8316, which is restated by an inflation index and by the payment of dividends and interest on equity per share paid by the Company from time to time, as from April 1, 2016. Based on those assumptions, the weighted average fair value of each option granted was R\$0.41.

The following table reconciles Austral Participações outstanding stock options:

	<u>Number of options</u>
Total options outstanding at December 31, 2015	8,938,315
Total options exercisable at December 31, 2015	5,268,176
Total options expired/extinguished in the year	50,000
Total options granted in the year	2,036,671
Total options outstanding at December 31, 2016	10,924,986
Total options exercisable at December 31, 2016	7,626,930

## Austral Resseguradora S.A.

Notes to financial statements (Continued)  
December 31, 2016 and 2015  
(In thousands of reais)

### 21. Stock option plan (Continued)

In the event that a participant has a work contract terminated either voluntarily or involuntarily, without cause, any non-exercisable stock options are automatically extinguished, with no right to damages or compensation. Exercisable stock options may be exercised within a set period as established in each individual contract.

In the event that a work contract of a participant is terminated for cause, all exercisable stock options and those which may not yet be exercised are automatically extinguished by operation of the law, irrespective of prior warning or damages.

The 10,924,986 outstanding stock options represent a dilution of up to 4.51% on the total of 231,242,145 Austral Participações' shares. No option was exercised up to December 31, 2016.

The effect of stock option plan relating to employees registered with the Company who were entitled to the options of Austral Participações is recorded in the Company's equity as capital reserve for the year ended December 31, 2016, in the amount of R\$2,273 (R\$1,962 at December 31, 2015).

### 22. Breakdown of P&L accounts

#### a) Gross written premiums

	<u>12/31/2016</u>	<u>12/31/2015</u>
Reinsurance premiums	<b>360,149</b>	436,797
Premium for contracts in force but not issued	<b>14,056</b>	2,120
Retrocessions accepted	<b>27,734</b>	28,952
Changes in technical reserves	<b>(7,773)</b>	(1,602)
Earned premium	<b>394,166</b>	466,267

#### b) Incurred claims

	<u>12/31/2016</u>	<u>12/31/2015</u>
Indemnities reported	<b>(290,501)</b>	(306,237)
Claim expenses	<b>(83)</b>	(134)
Salvages and reimbursements	<b>36</b>	264
Changes in incurred but not reported claims reserve	<b>(8,165)</b>	(7,156)
Total	<b>(298,713)</b>	(313,263)

## Austral Resseguradora S.A.

Notes to financial statements (Continued)  
December 31, 2016 and 2015  
(In thousands of reais)

### 22. Breakdown of P&L accounts (Continued)

c) Acquisition costs

	<u>12/31/2016</u>	<u>12/31/2015</u>
Brokerage	(9,446)	(10,959)
Changes in deferred brokerage	(445)	1,229
Total	<u>(9,891)</u>	<u>(9,730)</u>

d) Other operating income and expenses

	<u>12/31/2016</u>	<u>12/31/2015</u>
Other income	961	1,317
Expenses with profit sharing and reinsurance accepted	16,759	(99,635)
Other expenses	(1,529)	(315)
Total	<u>16,191</u>	<u>(98,633)</u>

e) Retrocession income (expenses)

	<u>12/31/2016</u>	<u>12/31/2015</u>
Change in incurred but not reported claims reserve	1,579	(2,702)
Claim expenses	12	40
Indemnity recovery	59,684	143,909
Ceded retrocession premium	(136,793)	(163,136)
Income - profit sharing	5,105	5,885
Changes in unearned premium reserve	(2,977)	6,036
Total	<u>(73,390)</u>	<u>(9,968)</u>

f) Administrative expenses

	<u>12/31/2016</u>	<u>12/31/2015</u>
Own personnel and social charges	(6,376)	(6,284)
Occupancy and operation	(2,448)	(2,240)
Third-party services	(4,272)	(2,745)
Depreciation and amortization	(395)	(667)
Publicity and advertising	(159)	(176)
Other	(350)	(195)
Total	<u>(14,000)</u>	<u>(12,307)</u>

## Austral Resseguradora S.A.

Notes to financial statements (Continued)  
December 31, 2016 and 2015  
(In thousands of reais)

### 22. Breakdown of P&L accounts (Continued)

#### g) Tax expenses

	<u>12/31/2016</u>	<u>12/31/2015</u>
COFINS expenses	(3,949)	(4,129)
PIS expenses	(754)	(787)
Inspection fees	(1,077)	(852)
Other	(506)	(696)
Total	<u>(6,286)</u>	<u>(6,464)</u>

#### h) Financial income (expenses)

	<u>12/31/2016</u>	<u>12/31/2015</u>
Income		
Securities measured at fair value through profit or loss	41,128	33,453
Securities available for sale	9,924	7,894
Reinsurance operations	108,157	111,665
Other income	4,610	11,927
Expenses		
Securities measured at fair value through profit or loss	(4,081)	(3,163)
Securities available for sale	(353)	(115)
Reinsurance operations	(113,523)	(104,373)
Other expenses	(8,965)	(4,587)
Total	<u>36,897</u>	<u>52,701</u>

### 23. Basic earnings per share

As required by CPC 41, the tables below present the reconciliation of income for the year with the amounts used to calculate basic and diluted earnings per share.:

	<u>12/31/2016</u>	<u>12/31/2015</u>
Numerator		
Net income for the year	33,789	43,357
Denominator (in thousands of shares)	<u>211,100</u>	<u>211,100</u>
Basic earnings per share	0.16	0.20

Basic earnings per share is calculated by dividing income for the year by the total number of outstanding shares in the period.

The Reinsurer has not issued and/or granted equity instruments that should be considered for purposes of calculating diluted earnings per share, as determined by CPC 41. Accordingly, diluted earnings per share do not present any difference in relation to the calculation of basic earnings per share shown above.



## **Austral Resseguradora S.A.**

Notes to financial statements (Continued)  
December 31, 2016 and 2015  
(In thousands of reais)

### **24. Subsequent events**

Circulars No. 543 of December 22, 2016 and No. 544 of December 27, 2016, issued by SUSEP, which provide for amendments to accounting standards to be complied with by open-ended private pension plan entities, companies engaged in selling certificate accounts with lottery prizes, insurance and local reinsurance entities, effective as from January 1, 2017, did not affect the Reinsurer's financial statements.

### **25. Professionals in charge**

#### **Board Members**

Gilberto Sayão da Silva  
Alessandro Monteiro Morgado Horta  
Bruno Augusto Sacchi Zarembo

#### **Chief Executive Officer**

Bruno de Abreu Freire

#### **Executive Board**

Petrônio Duarte Cançado

#### **Accounting Manager**

Arthur Teixeira Rodrigues  
CRC RJ - N° 078781/O-0

#### **Actuary**

Claudia Novello Ribeiro  
MIBA No. 2029



Centro Empresarial PB 370  
Praia de Botafogo, 370  
5º ao 10º andar - Botafogo  
22250-040 - Rio de Janeiro - RJ - Brazil  
Phone: +55 21 3263-7000  
ey.com.br

## **Independent actuaries' opinion**

In accordance with CNSP Ruling No. 321/2015 on Technical Reserves, Offsetting Assets and Capital Requirements as of December 31, 2016

Referring to:  
Austral Resseguradora S.A.

Issued by:  
EY Serviços Atuariais S.S.

## Independent actuaries' opinion

The Shareholders, Board of Directors and Officers

### **Austral Resseguradora S.A.**

Rio de Janeiro - RJ

CNPJ: 11.536.561/0001-26

We have audited the technical reserves and the retrocession assets recorded in the financial statements of Austral Resseguradora S.A. as of December 31, 2016, and its statements of minimum capital, offsetting assets used to cover technical reserves, solvency margin and retention limits as of that date, prepared under its management's responsibility, in accordance with actuarial principles set out by the Brazilian Institute of Actuaries (IBA) and with the rules issued by Brazil's Private Insurance Supervisory Office (SUSEP) and by Brazil's National Council for Private Insurance (CNSP).

### **Management's responsibility**

Management is responsible for the technical reserves and retrocession assets recorded in the financial statements, and for the schedules showing minimum capital, offsetting assets used to cover technical reserves, solvency and retention limits prepared in accordance with the actuarial principles informed by the Brazilian Institute of Actuaries (IBA) and with the rules established by Brazil's Private Insurance Supervisory Office (SUSEP) and by Brazil's National Council for Private Insurance (CNSP), and for such internal control features as management determines are necessary to enable their preparation that are free from material misstatement, whether due to fraud or error.

### **Actuarial auditor's responsibility**

Our responsibility is to express an opinion solely on the items informed in paragraph one hereof, based on our actuarial audit procedures conducted in accordance with the general actuarial principles issued by the Brazilian Institute of Actuaries (IBA) and also based on our past knowledge of and expertise in adequate actuarial practices.

Those actuarial principles require that actuarial audit be planned and performed in order to obtain reasonable assurance about whether the respective audited items are free from material misstatement.

With special regard to the entity's solvency, our responsibility for expressing an opinion refers only to the adequate recognition of technical reserves and offsetting assets used to financially cover such reserves, according to the foregoing rules and principles, and to the audited entity's compliance with capital requirements pursuant to the minimum limits stipulated in current rules defined by Brazil's Private Insurance Supervisory Office (SUSEP) and by Brazil's National Council for Private Insurance (CNSP), and does not refer to the quality and valuation of financial coverage of technical reserves, net of offsetting assets, and capital regulatory requirements.

An actuarial audit involves performing procedures selected to obtain actuarial audit evidence about the amounts of technical reserves and retrocession assets recorded in the financial statements and of the statements of minimum capital, offsetting assets used to cover technical reserves, solvency margin and retention limits. The procedures selected depend on the actuarial auditor's judgment, including the assessment of the risks of material misstatement, whether due to fraud or error. In making those risk assessments, the actuary considers internal control relevant to design actuarial audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the audited entity's internal control.

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

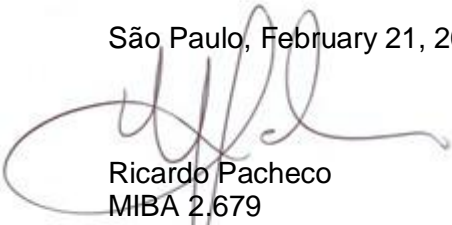
### **Opinion**

In our opinion, the technical reserves and the retrocession assets recorded in the financial statements of Austral Resseguradora S.A. as of December 31, 2016, and its statements of minimum capital, offsetting assets used to cover technical reserves, solvency margin and retention limits as of that date were prepared, in all material respects, in accordance with the rules and guidance issued by Brazil's Private Insurance Supervisory Office (SUSEP), by Brazil's National Council for Private Insurance (CNSP) and by the Brazilian Institute of Actuaries (IBA).

### **Other matters**

In the context of our responsibilities described above, considering the assessment of risks of material misstatement in the items within the scope defined in the first paragraph, we also applied selected procedures on the databases provided by the Reinsurer and used in our actuarial audit, tested on a sampling basis. We believe that the data selected in our work is capable of providing reasonable assurance to enable those items within the scope defined in the first paragraph to be free from material misstatement. Additionally, also based on selected procedures and on tests applied on samples, we observed that, within the scope of said samples, there is a reasonable correspondence of the data that served as basis for calculation of the items within the scope defined in the first paragraph with those submitted to SUSEP by means of the respective Statistical Tables, for the year ended December 31, 2016.

São Paulo, February 21, 2017.



Ricardo Pacheco  
MIBA 2.679  
ERNST & YOUNG  
Serviços Atuariais S.S.  
CNPJ No. 03.801.998/0001-11  
CIBA 57