



# **SOMERSET REINSURANCE**

**Financial Condition Report  
For the twelve-month (12) period ending  
31st December 2016**

# Content

---

Introduction	3
Business and Performance	3
Governance Structure	6
Company Risk Profile	15
Solvency Valuation	18
Capital Management	19
Subsequent Events	22

---

Somerset Reinsurance Ltd. (the “Company” or “Somerset Re”) was incorporated in Bermuda on 18<sup>th</sup> September 2014, and licensed as a Class E insurer by the Bermuda Monetary Authority on 12<sup>th</sup> December 2014, to write Long-Term (life) Reinsurance. Somerset Re was established as an Irish tax resident company. To date, Somerset Re has written Long-Term (life and annuity) reinsurance business.

**1. BUSINESS PERFORMANCE**

**a. Name of Insurer**

Somerset Reinsurance Ltd.

**b. Supervisors**

Insurance Supervisor

Bermuda Monetary Authority  
BMA House  
43 Victoria Street, Hamilton  
Bermuda

Group Supervisor

Bermuda Monetary Authority  
BMA House  
43 Victoria Street, Hamilton  
Bermuda

**c. Approved Auditor**

Statutory Reporting

Ernst & Young Ltd.  
3 Bermudiana Road  
Hamilton HM08  
Bermuda

GAAP Reporting

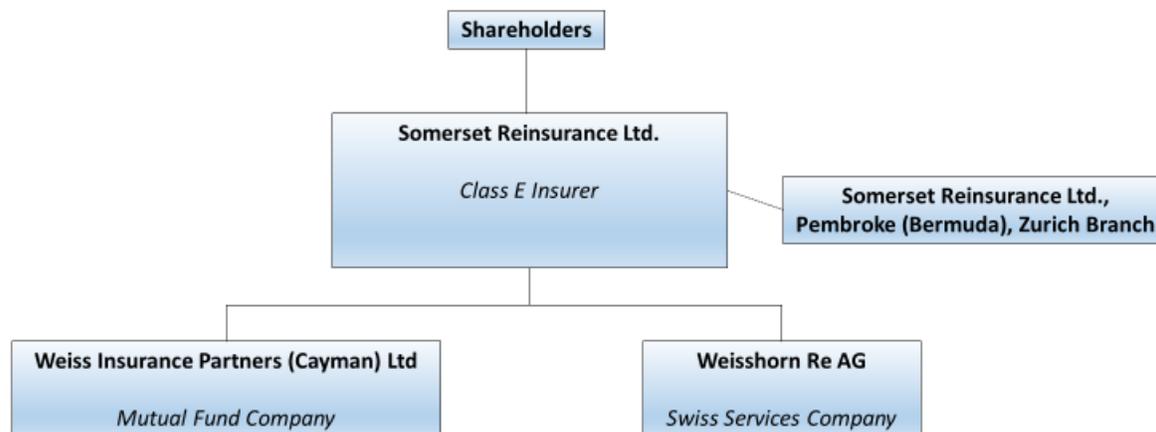
Ernst & Young Ltd.  
3 Bermudiana Road  
Hamilton HM08  
Bermuda

**d. Ownership Details**

The company is privately owned by institutional and individual high net worth investors.

## e. Group Structure

The following provides details of the Company in the Group Structure:



## f. Insurance Business Gross Premiums by Business Segment and by Geographical Region

The Company primarily offers treaty reinsurance coverage in the United States for Long-Term (life) business. This includes both life and annuity business. Gross Premiums (in thousands) were \$146 in 2016 and \$22,862 in 2015.

## g. Performance of Investments & Material Income & Expenses for the Reporting Period

### Performance of Investments for the Reporting Period

#### i. Overview

The Company invests in a combination of high quality diversified fixed income securities and a diversified multi-strategy investment portfolio. Multi-strategy investments are held through the Company's mutual fund subsidiary.

#### ii. Performance

Despite declining credit spreads throughout 2016 and a sharp rise in rates in the fourth quarter, total fixed income returns were strong, posting excess returns of 126bps over the Bloomberg Barclays Bond Index.

The Company's diversified multi-strategy investment is a constrained total return strategy that is expected to be uncorrelated with the fixed income market. The investment thesis for the combined approach seeks to reduce overall systemic market risk. The fund performed well in 2016 despite volatility in certain sectors of the market.

2016 Somerset Re investment highlights are as follows:

	YE2016 \$ MV Balance	YE 2016 \$ BV Balance	2015 Return*	2016 Return
Fixed Income	\$ 70,654,543	\$ 71,205,188	1.01%	3.91%
Multi-Strategy	\$343,794,613	N/A	-0.28%	12.68%

	2015 Return*	2016 Return
Bloomberg Barclays Aggregate Bond Index	0.89%	2.65%

\* Since inception

#### Material Income & Expenses for the Reporting Period

The Company's main revenue source is investment income on fixed income assets and returns on the diversified multi-strategy investment. The Company's major expenses arise from interest credited to policyholders on fixed annuity and universal life policies and home office expenses. As the reinsurance portfolio grows over time, these items will be supplemented by increasing premium revenues and cost of insurance charges and increasing benefit related expenses.

(Reported in thousand units)

<u>Home Office Expense Type</u>	<u>2016</u>	<u>2015</u>
Employee-related	11,683	10,211
Other	342	269
<b>Total Home Office Expenses</b>	<b>\$12,025</b>	<b>\$10,480</b>

#### **h. Other Material Information**

In October 2016, the Company raised substantial additional capital, increasing the common share capital to approximately \$375 million.

In November 2016, following completion of the October capital raising activity, the Company was assigned a Financial Strength Rating of B++ and a Long-Term Issuer Credit Rating of "bbb" (Investment Grade) from A.M. Best.

With the effective date of December 19, 2016, the Company entered into a reinsurance agreement with a large national carrier to reinsure on a quota share basis its new issuance of certain fixed annuity contracts.

With the effective date of December 31, 2016, the Company entered into a binding letter of intent to execute a reinsurance agreement with a regional mid-west carrier to assume USD \$275,000,000 of annuity liabilities arising under deferred annuity policies written under certain policy forms. The reinsurance agreement was executed on March 1, 2017.

## 2. GOVERNANCE STRUCTURE

The Company's governance structure is comprised of senior management and the Board and is established to:

- Ensure that the Company has an appropriate corporate governance and risk management framework;
- Ensure the enterprise risk management is maintained at high standards;
- Ensure the business is operating in an efficient and effective manner
- Ensure management takes immediate corrective action as needed; and
- Periodically update risk management and control procedures for the organization based on the risks identified.

### a. Board and Senior Executive

#### i. Board and Senior Executive Structure, role, responsibilities and segregation of responsibilities.

The Board of Director's ("the Board") role is to exercise oversight in relation to the organization. This includes establishing the company's risk appetite and decision-making relating to certain matters which are of strategic importance to the company. All other matters, which include executive decisions and risk oversight, are delegated to the Senior Management of the Company led by the Chief Executive Officer. The Chief Executive officer has established a Risk and Asset Liability Management Committee which meets quarterly and handles the risk oversight matters.

As of year-end 2016, the Board consisted of seven (7) directors, including 4 non-executive directors and 3 executive directors. At the January 2017 Annual General Meeting, two additional non-executive directors were elected to the board and two of the executive directors did not stand for re-election. The Board members identified below include the two non-executive directors elected in January 2017 and do not include the executive directors who did not stand for re-election.

The Company's Senior Management includes the Chief Executive Officer, the Chief Administration and Compliance Officer, the Chief Investment Officer, the Chief Marketing Officer, the Chief Financial Officer, the Chief Risk Officer (position currently held by the CFO) and the Chief Underwriter and Chief Actuary.

#### ii. Remuneration Policy

The Company's management remuneration policy provides for a fixed base salary along with an annual discretionary and performance-based bonus which varies in accordance with both the company's and individual's performance. Additionally, Senior Management have received stock options to align executive remuneration with the interests of its common shareholders.

Board members, excluding the executive director, receive fees as remuneration for their work as directors and do not receive bonuses or stock options.

The CEO, working with external independent consultants, conducts periodic industry reviews of compensation policy and levels and reviews results with the Board to ensure remuneration is appropriate and in line with the desired risk profile of the company

**iii. Pension or Early Retirement Schemes for Members, Board and Senior Employees**

The Company provides all employees with pension benefits. Bermuda employees, excluding U.S taxpayers, participate in a defined contribution plan. Swiss employees participate in a defined benefit plan as per Swiss employment law requirements. U.S taxpayers participate in a 401(k) plan. The Company does not have any early retirement schemes. There is no pension plan for Board members.

**iv. Shareholder Controllers, Persons who Exercise Significant Influence, the Board or Senior Executive Material Transactions**

George Weiss is a significant shareholder and a director of the company. He is also the managing member of Weiss Multi-Strategy Advisors (or “WMSA”), the investment management company that manages the Company’s diversified multi-strategy investment portfolio. Through its mutual fund affiliate, the Company pays management fees and performance fees to WMSA.

**b. Fitness and Proprietary Requirements**

**i. Fit and Proper Process in assessing the Board and Senior Executive**

Five (5) of the Company’s board members are elected by the shareholders, and stand for re-election at each annual general meeting of the Company. Two (2) of the Company’s board members are “designated” by major shareholders per the terms of the shareholders’ agreement.

Of the elected directors, each was selected to stand for election based on a rigorous review of the individual’s background and expertise. Three have more than 35 years of experience in the insurance industry, including senior executive roles in general management and/or financial management.

The designated directors are both highly qualified, a financial professional and an actuary, with substantial experience in the oversight and governance of insurance and reinsurance companies.

Function and business unit heads are authorized to hire middle management and other staff to ensure there is sufficient expertise to achieve their respective area goals. The Chief Executive Officer is responsible for Senior Management hires, although such decisions are subject to approval by the Board.

ii. **Board and Senior Executives Professional Qualifications, Skills and Expertise**

Below are details of the Board and Senior Executives qualifications, skills and expertise:

**Board**

***Richard Booth – Chairman of the Board and Non-Executive Director***

Mr. Booth is a veteran of the life and property-casualty insurance industry with more than 45 years of diversified experience. He is currently an advisor to Weiss Multi-Strategy Advisers LLC as well as a number of other financial services organizations. He is a board member of The Hanover Insurance Company and Adamas Pharmaceuticals as well as several private company boards and venture firms. He has previously served on the boards of SunLife, The Travelers Insurance Company, the HSBC Group and Phoenix Mutual. Previous executive leadership positions include president and chief operating officer of The Travelers Insurance Company, Chairman and CEO of the Hartford Steam Boiler Insurance Company, Vice Chairman of AIG and Vice Chairman of Guy Carpenter LLC.

Mr. Booth is a member of the American Institute of Certified Public Accountants, the Society of Financial Service Professionals and the CFA Institute. Mr. Booth holds the CPA, CLU and ChFC designations. He is a graduate of the University of Hartford where he earned both B.S and M.S. degrees in accounting.

***Charles Collis – Non-Executive Director***

Mr. Collis is a director of Conyers Dill & Pearman Limited. He joined the firm in 1990. He practices in the firm's Insurance Group, specializing in re/insurance, advising on corporate and regulatory matters.

Mr. Collis has advised on the establishment of numerous life and general business re/insurance companies, including advising on their private placement, IPO and M&A transactions. The convergence of the insurance markets and capital markets has led Mr. Collis to also specialize in insurance linked securities.

Mr. Collis graduated from Trinity College, University of Toronto in 1984 with a BA (Hons) degree and received an LLB from University College, London in 1988. He was called to the Bar of England & Wales in 1989 (he does not currently practice in the UK), and was admitted to the Bermuda Bar in 1991.

***Patrick Kelleher – Executive Director and CEO***

Mr. Kelleher is an accomplished business leader with experience leading insurance and reinsurance businesses on an international scale, engineering changes and redesign to improve profitability and returns. He has strong financial management and risk management experience across a range of life and non-life insurance businesses.

In his most recent roles as President & CEO of US Life Insurance and President & CEO of Insurance

and Wealth Management at Genworth, from 2011 to 2013, Mr. Kelleher had overall responsibility for repositioning of the US Life Companies, European Lifestyle Protection and Wealth Management businesses. Prior to that, as Senior Vice-President and Chief Financial Officer from 2007 through 2011, he had overall responsibility for financial management and financial reporting functions.

Prior to Genworth, Mr. Kelleher served as Executive Vice President and Chief Financial Officer at AEGON/Transamerica Reinsurance. Additionally, he led the annuity reinsurance business during the latter part of his tenure.

Mr. Kelleher previously held multiple positions at Manulife Financial, including Vice-President, Reinsurance and Vice-President and Chief Financial Officer for Global Reinsurance, and at Sun Life Assurance Company of Canada. He is a Fellow of the Society of Actuaries, a Fellow of the Canadian Institute of Actuaries, and a member of the Certified Professional Accountants Association of Canada (CPA.CGA.). Pat has a Bachelor's Degree from Franklin & Marshall College.

***Walker Rainey – Non-Executive Director and Audit Committee Chair***

Mr. Rainey is an independent, non-executive Director of Starstone Specialty Holdings Limited - an Enstar company, W&W Asset Management Dublin Limited, Aetna Health Insurance Company of Europe Limited and W&W Advisory (Dublin) Limited. He was previously a Director and Chairman of the Audit Committee for Aegon Ireland and a Director for Transamerica International Reinsurance Ireland Limited.

Mr. Rainey was formerly Managing Director, Executive Vice President and Chief Financial Officer of Alterra Capital Europe Limited. He also served as Chief Financial Officer, Director and Company Secretary for XL Europe Limited

He graduated with Honors from Queens University with a B.Sc. in Economics and Accounting and is a Fellow of the Institute of Chartered Accountants in Ireland.

***George Weiss – Non-Executive Director***

Mr. Weiss is the Chief Executive Officer and Chairman of Weiss Multi-Strategy Advisers LLC, the Sponsor, which is registered as an investment adviser with the U.S. Securities and Exchange Commission and with the U.S. Commodity Futures Trading Commission and National Futures Association as a Commodity Pool Operator.

Mr. Weiss founded the predecessor to the Sponsor, George Weiss Associates, Inc., in 1978. Prior to establishing the Weiss entities, Mr. Weiss specialized in utility stocks and investing on behalf of institutional clients at Bache Halsey Stuart, Inc., in Hartford and briefly at Faulkner, Dawkins and Sullivan, Inc.

He is a graduate of The Wharton School of Finance at the University of Pennsylvania where he is a Trustee Emeritus. Mr. Weiss is the founder of Say Yes to Education, Inc., a charity dedicated to the educational advancement of inner-city students, a trustee of the Orphan Disease Pathway Project Foundation and a board member of the Woodrow Wilson Foundation.

***David I. Schamis - Non-Executive Director***

Mr. Schamis is Founding Partner and Chairman of the Investment Committee at Atlas, and is based in New York. Previously, Mr. Schamis worked at J.C. Flowers from 2000 to January 2014, most recently as a Managing Director and member of the Management Committee. Mr. Schamis joined J.C. Flowers at its inception and has had significant experience investing in North America, South America, Europe and Asia. His day-to-day responsibilities included transaction and sourcing execution, portfolio company monitoring and firm operations. Prior to J.C. Flowers, Mr. Schamis worked in the financial institutions investment banking group at Salomon Smith Barney LLC from 1995 to 2000.

Mr. Schamis was previously Chairman of the Board of Directors of Fox-Pitt Kelton and Ascensus Retirement Services (formerly Crump Group, Inc.). He also served on the Board of Directors for Symetra Financial Corporation and MF Global Ltd. In 2007 and 2008, Investment Dealers' Digest magazine named Mr. Schamis to its "40 Under 40" list.

A native of Plainview, New York, Mr. Schamis earned a Bachelor of Arts degree in Economics from Yale University. He served as Co-Chairman of the Class of 1995's Reunion Gift Committees in 2005, 2010 and 2015. Mr. Schamis remains active in his community and has coached football and lacrosse at various levels.

***Michael H. Winkler - Non-Executive Director***

Michael Winkler started his professional career as an actuary in Winterthur Life and worked there in product development, ALM and other areas. After having worked in Swiss Re for four years, he re-joined Winterthur and became responsible for the technical part of the group's life units around the globe.

In 2007, Mr. Winkler joined Munich Re group and built up a life team in New Re in Zurich, focusing on financing transactions and Variable Annuity reinsurance. He built up New Re's reputation as a specialized life reinsurer and is a well-known speaker in conferences.

In 2014, Mr. Winkler established his own advisory firm RefinSol, providing specialized consulting for Financial Solutions.

**Senior Executives**

***Patrick Kelleher – Chief Executive Officer***

See biography in Board section.

***Thomas F. Conroy – Chief Administrative & Compliance Officer***

Mr. Conroy has been an insurance executive for over 35 years, with proven experience leading complex financial businesses. Prior to joining the Company, from July 1, 2001 to the present, Mr. Conroy founded and is the managing principal at Mann Conroy Eisenberg & Associates ("Mann Conroy"), where he and his team obtained patents on insurance management methods and products, as well as developed tax-favored and capital-favored reinsurance products for US based

life insurance companies. Except for ongoing patent maintenance efforts, the firm is now dormant.

Prior to Mann Conroy, Mr. Conroy was President of ING Reinsurance from 1993 to 2001, where the unit increased insurance in force from \$35B in 1992 to \$250B in 2000, with an increase in pre-tax profits from \$10M to \$95M. He was also concurrently President of ING Institutional Markets from 1993 to 1998. This unit marketed sophisticated insured investment products to institutions. Prior to ING Re and ING Institutional Markets, Mr. Conroy served as Executive Vice President & CFO and Director of Security Life of Denver and affiliates (an ING Unit).

From 2001 to 2009, he served as CFO and a Director of Teton Energy. Mr. Conroy started his career at Ernst & Ernst (now Ernst & Young). Mr. Conroy is a retired captain in the US Army Reserve and has an MBA (Mathematical Models and Computer Sciences) from the University of Chicago, a BSC (Accounting) from DePaul University, and is a CPA.

#### ***Stephen E. Gallant – Chief Investment Officer***

Mr. Gallant has over three decades of trading and investment management experience, including most recently at ING Investment Management from 1997 to 2008, where he ultimately was Head of Rates for ING Investment Management's Proprietary Fixed Income Group (2003 to 2008). He served on the firm's Executive Team, where the firm set investment strategy, made tactical decisions, addressed operational needs, and oversaw risk for the firm's \$80 billion portfolio. Additionally, he had the responsibility for all of the group's financial derivative business, a \$30+ billion notional portfolio of asset and liability hedges in the fixed income, equity, and currency markets.

At ING, Mr. Gallant was responsible for the well-respected collateralized mortgage obligation investment strategy (CMO-B), an interest-rate sensitive mortgage derivative strategy that consistently outperformed the mortgage market. From inception (1992), this mortgage derivative strategy experienced 293% cumulative excess returns over the Lehman Mortgage Index, never posting negative total returns. Under Mr. Gallant, the CMO-B investment process was made robust, allowing it to grow to \$6.5 billion in assets, making it one of the largest of its kind in the country.

Mr. Gallant also founded and acted as co-manager of Portage Equity Investments I and II, an early-stage venture capital fund that principally invested in medical device and computer technology companies. Mr. Gallant is a past member of the investment committee for the Clemson University Foundation. Stephen is a member of the CFA Institute, where he holds the Chartered Financial Analyst designation. He received a BS in finance from Washington University in St. Louis.

#### ***Brian G. Holland – Chief Marketing Officer***

Mr. Holland has over 30 years of experience building and leading insurance organizations. Most recently, Mr. Holland was a founding member and served from 2011 to March, 2013 as Senior

Vice President of the Life Solutions Group at Willis Re, responsible for building Willis Re's entry into life and annuity reinsurance and was responsible for all deal origination. From 2003 – 2011, Mr. Holland served as Principal at Mann Conroy Eisenberg & Associates, LLC.

From 2000 to 2003, Brian served as Executive Vice President and member of the Board of Directors at Annuity & Life Re America. He was responsible for developing the start-up US Life reinsurance operations for one of the pioneers in the offshore non-U.S. life reinsurance market. As Chief Marketing Officer, he secured 29 new reinsurance clients in the first 24 months of operation and the group grew to \$115 billion of life insurance in force.

Prior to joining Annuity & Life Re, Mr. Holland was Vice President, Domestic and International Risk Management and Global Chief Marketing Officer at ING Re, as well as being responsible for developing ING Re's entry into the Bermuda and Japan markets.

Mr. Holland also held senior marketing and underwriting positions at Transamerica Re and General Re. He received his Bachelor of Science degree in Business Management /Marketing from Providence College, Providence, RI.

***Steeve Jean – Chief Financial Officer and Acting Chief Risk Officer***

Mr. Jean was most recently a Principal with KPMG. He has over 25 years of experience in the insurance industry, working with international insurance groups and Big Four firms. At KPMG, Mr. Jean assisted companies with International Accounting Standards, reinsurance transactions, mergers and acquisitions, actuarial system implementations, stress testing and financial statement conversions.

Prior to KPMG, Mr. Jean was a Vice-President at Transamerica where his responsibilities included financial reporting, capital management, acquisitions and reinsurance with financial oversight over international operations.

At Old Mutual, Mr. Jean led a team responsible for both U.S. and Bermuda financial reporting.

Mr. Jean spent several years at Ernst & Young where he led the delivery of large advisory projects. Steeve began his career with MetLife's Canadian operations with a focus on financial management for both the group and individual life divisions.

Mr. Jean is a Fellow of the Society of Actuaries, a Fellow of the Canadian Institute of Actuaries and a Member of the American Academy of Actuaries. He obtained his Bachelor's degree in Applied Mathematics from the University of Sherbrooke.

***Robert J. Reale – Chief Underwriter and Chief Actuary***

Mr. Reale has over 35 years of insurance and reinsurance experience. Prior to joining the Company in September, 2013, Mr. Reale served in the Insurance Solutions Group at BNP Paribas for three years originating and structuring capital solutions for life insurers, including an innovative \$2 billion contingent capital solution syndicated in 2011. Mr. Reale had a similar role

at Deutsche Bank from 2007-2009. Prior to joining Deutsche Bank, Mr. Reale was the life insurance structured financing solutions practice leader at Towers Wyatt, consulting life insurers, reinsurers, and banks on numerous capital management and insurance-related activities.

Most of Mr. Reale's experience is in life reinsurance. Mr. Reale joined Annuity and Life Re in Bermuda as Chief Underwriter and Chief Operating Officer in 1998 and was instrumental in their successful \$350 million public launch in April 1998, securing an A- rating from AM Best and S&P at inception. By 2001, Mr. Reale's Bermuda-based team had assumed over \$100 billion of life insurance and \$1.6 billion of annuity insurance from US and Canadian life insurers, with results prompting an upgrade to an A rating from S & P. Also in 2001, Mr. Reale created and completed the first multi-year financing facility to efficiently fund over \$300 million of excess life reserves. Prior to that, Mr. Reale was at Swiss Re for eight years as head of actuarial marketing for US life operations and 10 years at a large life insurer pricing insurance products. Mr. Reale has also served on the Board of Directors for RGA-Swiss Financial, a joint-venture company organized to assume a significant amount of financial reinsurance.

Mr. Reale graduated from Fordham University in 1978 with a BA in Mathematics. He is a Fellow of the Society of Actuaries, a member of the American Academy of Actuaries, and an Approved Actuary for South Carolina.

### **c. Risk Management and Solvency Self-Assessment**

#### **i. Risk Management Process & Procedures to Identify, Measure, Manage and Report on Risk Exposures**

The Company's risk management program follows a four-step approach to risk exposures:

- Identify Risk – identify significant risks that could materially affect the financial position or objectives of the organization and include these risks in the Company's risk inventory.
- Measure – from the Company's assumed exposure, measure the risks in the Company's risk inventory. Each exposure is assessed based on the organization's risk categories and provides the impact the exposure has on the organization (i.e. solvency, liquidity requirements, etc.).
- Manage – assess the response to the exposure based on acceptance, mitigation, transferability or avoidance and consider it in the context of the Company's risk appetite statement, risk tolerance levels and limits. If the exposure is to occur in the future, ensure there are controls in place to manage the exposure to within tolerance and limits before it occurs or have an effective plan in place to mitigate if the exposure becomes outside tolerance and/or limits.
- Report - ensure that the Company's Risk Management and Executive Committees are informed of all material risk exposures and that these are tracked against the Company's risk guidelines and that compliance with guidelines is reviewed by the Board.

#### **ii. Risk Management and Solvency Self-Assessment Systems Implementation**

The Company's risk management framework is implemented and integrated into its operations through the systems, processes, procedures, and controls developed and documented by management. The Risk and Asset/Liability (RALM) Committee reviews the controls in place to

ensure they are effective on a quarterly basis.

Management information arising from the risk management process is used to complete Solvency Self-Assessments of the quantity and quality of capital required to support the Company's business goals given the amount of risk the Company has taken on (or plans to take on) and environmental factors.

The Solvency Self-Assessment is reviewed at least annually and when major transactions are considered to ensure that the Company's capital adequacy and liquidity resources are sufficient based on the risks to the Company that arise from its operations. The Company uses a combination of proprietary and third-party (vendor) models to determine the adequacy of capital.

**iii. Relationship Between Solvency Self-Assessment, Solvency Needs & Capital, and Risk Management**

The Company's Solvency Self-Assessment is a formal guide that outlines the Company's strategy and short and longer term business goals, and the quality and quantity of capital needed to support these plans. The Solvency Self-Assessment seeks to identify and measure all material risks, and aids in the decision-making process regarding which risks it can eliminate, transfer or retain within its agreed risk appetite and tolerance. The process, upon considering severe stress events, also facilitates the identification of contingent sources of liquidity and capital support to ensure that the Company continues to be able to achieve its strategic objectives.

**iv. Solvency Self-Assessment Approval Process**

The Company's Solvency Self-Assessment Report is prepared by the Senior Management team, in consultation with the relevant business units, and reviewed by the Chief Executive Officer. After review, and a consideration of completeness by Senior Management and the Risk Management (RALM) Committees, the assessment Report is provided to the Board for review, discussion and approval.

**d. Internal Controls**

**i. Internal Control System**

The Company has systems, processes and procedures to ensure that data and reporting is reliable, organizational policies are adhered to, and adequate security measures are implemented. If any deficiencies or material weaknesses are found, they are documented and presented to the Board. The Board monitors the progress on remediation plans.

**ii. Compliance Function**

The Company's Chief Compliance Officer has the responsibility to monitor regulatory changes in the relevant jurisdictions and compliance with applicable existing laws, including regulatory reporting and public disclosure requirements. The Chief Compliance Officer monitors compliance with organizational policies and procedures and adherence to the Company's Code of Ethics. All violations of the risk matrix are reported to the Board on a timely basis.

#### **e. Internal Audit**

The Company currently does not have an internal audit function. The Company is in the process of developing an internal audit function through outsourcing or co-sourcing which will complete the Company's "Three Lines of Defense" model.

#### **f. Actuarial Function**

The Company's Chief Actuary is responsible for setting, monitoring and adjusting technical provisions which comprise both the best estimate liabilities (or reserves) and a risk margin, and these technical provisions are subject to a further independent review by the Company's external Appointed Actuary.

The technical provisions are also reviewed by the Chief Executive Officer and Chief Financial Officer, who are both qualified actuaries, as part of the quarterly management reviews of the financial statements.

#### **g. Outsourcing**

##### Outsourcing Policy and Key Functions that have been Outsourced

The Company has an outsourcing and purchasing policy that outlines Board delegation regarding various spending thresholds that can be authorized by staff at various levels, and includes those which require Board authorization. The Company has not outsourced any control functions (being Actuarial, Risk Management, Compliance and Finance). Some of the services and functions that are outsourced include IT infrastructure, Reinsurance Administration, Investment Accounting and Legal.

#### **h. Other Material Information**

No other material information to report.

### **3. COMPANY RISK PROFILE**

#### **a. Material Risks the Insurer is Exposed to During the Reporting Period**

The Company's main risk categories are insurance, market, credit, operational, liquidity, strategic, and reputational risk.

- Insurance Risk – the risk of loss arising from inadequate pricing or from adverse change in the value of insurance liabilities due to adverse bio-metric results, adverse policyholder behaviour and adverse changes in policy guaranteed elements.
- Interest Rate Risk – the risk of loss arising from investment returns lower than assumed in pricing.
- Market Risk – the risk of loss or of adverse change in the financial situation resulting, directly or indirectly, from fluctuations in the level and in the volatility of market prices of financial instruments or in the Net Asset Value of the diversified multi-strategy investment.
- Credit Risk - The Company is exposed to credit risk, which is the risk that a counterparty will be unable to pay amounts in full when due. The carrying amount of the cash and cash equivalents, restricted cash and cash equivalents, fixed income securities, investments in unconsolidated affiliate entities, funds withheld, other receivables and rental deposits represent the Company's maximum exposure to credit risk.

- Operational Risk – the risk of loss arising from inadequate or failed internal processes, personnel or systems, or from external events.
- Liquidity Risk – Liquidity risk is the risk that not enough cash resources may be available to pay obligations when due or to post-collateral on existing reinsurance transactions. The Company's exposure to liquidity risk is based on the earliest time the Company could be contractually required to repay any outstanding amounts or post collateral.
- Strategic Risk - the risk of loss arising from the adverse effect of management decisions on both business strategies and their execution, as well as from unexpected changes in environmental trends that damage the operating economics of the business.
- Reputational Risk - the risk that business practices, conduct of business and associations may damage stakeholder confidence.
- Key Personnel Risk – The Company depends on highly experienced individuals to successfully execute its strategy.

The Company uses a combination of proprietary and vendor models to evaluate and quantify these risks, whenever possible. Market and credit risks materially increased during the period because additional equity capital raised in October 2016 was invested in securities that expose the company to additional market and credit risk.

#### **b. Risk Mitigation in the Organization**

The Company controls risk through a variety of ways, but ultimately risks are reported and monitored centrally by the Chief Risk Officer and the Risk and ALM Committee. The Risk Management Function also verifies that risks are either kept within agreed limits or temporary breaches for unique situations are appropriately escalated to the Risk and Asset Liability Management Committee and either approved or corrected. Further, the Risk and Asset Liability Management Committee reviews the enterprise risk management framework and ensures the controls in place for managing the risk exposures are operating as intended. If a new risk is identified, the Risk Management Committee establishes new controls to manage the risk.

Additionally, the Company maintains a strong solvency capital position relative to its risk profile.

#### **c. Material Risk Concentrations**

The Company has policies governing risk concentrations in relation to counterparties, credit quality and sectors. These risks are addressed in the Company's Investment Management Policies and are monitored by the Risk and Asset Liability Management Committee.

Apart from highly rated sovereigns and associated sponsored agencies, the Company has a policy that prohibits exposure exceeding 2% of its fixed income portfolio to any single issuer (not including affiliates). The Company manages credit risk exposure by limiting below investment grade assets to 3% of the entire fixed income portfolio and maintaining a minimum portfolio credit rating of A3. The Company also has asset class and industry sector limits.

The Company manages the risk exposure to the diversified multi-strategy investment through a single issuer limit of 3% of the gross exposure and a 12% annualized volatility limit.

The company has policies governing underwriting risk which addressed in the Company's Underwriting Policy and are monitored by the Underwriting Policy Compliance Committee and the Risk and Asset Liability Management Committee.

**d. Investment in Assets in Accordance with the Prudent Person Principles of the Code of Conduct**

The Company's fixed income investment portfolio is managed by the investment team in accordance with the Company's investment policy guidelines. These guidelines require that highly liquid and low volatility fixed income securities support technical provisions to ensure that claims can be paid on a timely basis. The size of the high-quality investment portfolio is determined by the amount of technical provisions recorded for the quarter plus a large safety buffer.

The Company's multi-strategy investment is highly diversified and liquid and is managed to within 12% annualized volatility limit. Management oversees this limit by monitoring 90-day implied volatility, annualized standard deviations of gross returns, and net delta adjusted exposures of the underlying investments.

These guidelines are reviewed on an annual or ad hoc basis if any significant deviations have occurred that affect the financial markets or if the risk appetite and tolerances of the Company change.

**e. Stress Testing and Sensitivity Analysis to Assess Material Risks**

The Company performs various stress tests on a monthly or annual basis to determine the adequacy of capital/liquidity to ensure regulatory requirements can be met. The tests performed relate to underwriting risk exposures, interest rate risk, and credit risk.

**Underwriting Risk Exposures**

Underwriting risk exposure is tested for changes in mortality, lapse/surrender, partial withdrawal, premium payments, crediting rate and interest rate driven dynamic lapse/shock surrender risk.

**Interest Rate Risk**

The Company's investment portfolio is tested for price sensitivity to interest rate changes and liquidity shocks as well as asset-liability mismatches to ensure that these will not impair the Company's ability to pay policyholder obligations, operational expenses and for unexpected events.

**Credit Risk**

The Company's reinsurance recoverable amounts and premium receivables are tested to assess the impact of a counterparty's ability to make payments in accordance with the contractual terms.

Based on the latest results, management of the Company believes that it has sufficient capital and liquidity to comply with the contractual obligations of the organization and regulatory requirements in the event the Company experiences.

### **Multi-Strategy Investment Risk**

The fund manager must manage the fund to a 12% annualized volatility limit by agreement with the company. Management oversees this limit by monitoring 90-day implied volatility, annualized standard deviations of gross returns, and net delta adjusted exposures of the underlying investments. To-date, annualized volatility has averaged approximately 7%.

## **4. SOLVENCY VALUATION**

### **a. Valuation Bases, Assumptions and Methods to Derive the Value of Each Asset Class**

The Company uses valuation principles outlined by the Bermuda Monetary Authority (the “BMA”) in “Guidance Note for Statutory Reporting Regime”. The economic valuation principles outlined in this document are to measure assets and liabilities on a fair value basis (which is the value that would be received upon the sale of an asset or paid to transfer a liability in an orderly transaction between open market participants at the measurement date). The fair value principles used for the assets are as follows:

- Cash and Cash Equivalents – includes cash time deposits and investments maturing within three months. The fair value of these holdings is determined by using mark to market valuation, or quoted market prices in active markets for similar assets with adjustments to reflect differences if mark to market valuation is not possible, or mark to model valuation otherwise.
- Fixed Income Securities – are valued in accordance with mark to market principles where possible or quoted market prices in active markets for similar assets with adjustments to reflect differences if mark to market valuation is not possible. For fixed income securities that are not actively traded and for which similar assets are also not actively traded, the Company uses pricing services to prepare inputs to assist the Company with mark to model valuations.
- Diversified Multi-Strategy Investment - includes primarily marketable fixed income and common stock and are valued using the quoted market prices.
- Accounts Receivable and Premium Receivable – are recorded at a fair value and balances due in more than one year have been discounted at the relevant risk free rate.
- Derivative instruments- are valued at quoted market prices. In the absence of an active market, prices are based on observable market inputs.

### **b. Valuation Bases, Assumptions and Methods to Derive the Value of Technical Provisions**

Insurance technical provisions comprise the sum of a best estimate liability, or reserve, and a risk margin. The best estimate reserve is determined as the highest asset requirement needed under the scenario-based approach to fund cash flows developed for each scenario. Technical provisions include a risk margin, in addition to the best estimate reserve, to reflect the uncertainty contained inherent in the underlying cash flows. The risk margin is calculated using the cost of capital approach and a risk-free discount rate term structure. The discount rate term structures are prescribed by the BMA for each reporting period.

The best estimate insurance reserves also include provisions for incurred but unreported claims

At 31st December 2016, the total Technical Provisions amounted to \$64.6 million comprising the following (reported in thousand units):

Best Estimate Reserve for Unreported Claims	\$628
Best Estimate Reserves - Life	\$18,683
Best Estimate Reserves – Funds on Deposit	\$44,645
Risk Margin	\$646

**c. Description of Recoverables from Reinsurance Contracts**

Recoverables from reinsurance contracts are based on principles similar to the gross best estimate and include reinstatement premiums required to be paid to the reinsurer, and expenses in relation to the management and administration of reinsurance claims.

**d. Valuation Bases, Assumptions and Methods to Derive the Value of Other Liabilities**

The Company’s liabilities also follow the valuations principles outlined by BMA’s “Guidance Note for Statutory Reporting Regime” which values liabilities at a fair value basis. All other liabilities are valued on an IFRS basis and settlements not expected to be settled within a year, are discounted using the prescribed discount rates provided by the BMA as at 31st December 2016. Loans and Notes Payable are valued on an IFRS basis and Derivative Instruments are valued at quoted market prices. In the absence of an active market, prices are based on observable market inputs.

**e. Any Other Material Information**

No additional material information to report.

**5. CAPITAL MANAGEMENT**

**a. Eligible capital**

**i. Capital Management Policy and Process for Capital Needs, How Capital is Managed and Material Changes During the Reporting Period**

The Company has very strong capital ratios as a result of completing new common share capital issuance in October 2016.

The Company seeks to maintain a strong capital base to support the development of its reinsurance business and to meet regulatory requirements and target rating agency capital requirements at all times.

Eligible Capital Categorized by Tiers in Accordance with the Eligible Capital Rules

At the end of the reporting period, the Company's Eligible Capital was categorized as follows:

(Reported in thousand units)

Tier 1	\$355,269
Tier 2	0
Tier 3	<u>0</u>
<b>Total</b>	<b>\$355,269</b>

All the capital is Tier 1, the highest quality capital, consisting of capital stock, contributed surplus, and statutory surplus.

ii. Eligible Capital Categorized by Tiers in Accordance to the Eligible Capital Rules Used to Meet ECR and MSM Requirements of the Insurance Act

At the end of the reporting period, the Company's Eligible Capital for its Minimum Margin of Solvency (MSM) and Enhanced Capital Requirement (ECR) was categorized as follows:

(Reported in thousand units)

	<b>Eligible Capital (MSM)</b>	<b>Eligible Capital (ECR)</b>
Tier 1	\$355,269	\$355,269
Tier 2	0	0
Tier 3	<u>0</u>	<u>0</u>
<b>Total</b>	<b>\$355,269</b>	<b>\$355,269</b>

iii. Confirmation of Eligible Capital That is Subject to Transitional Arrangements

None.

iv. Identification of Any Factors Affecting Encumbrances on the Availability and Transferability of Capital to Meet the ECR

The Company has entered contracts with cedants that require the Company to fully collateralize estimates of its obligations calculated by the cedant. Assets are held in trust accounts for the benefit for the cedant. These assets are released to the Company upon the payment of the obligations. Interest income arising from these assets accrues to the Company.

v. Identification of Ancillary Capital Instruments Approved by the BMA

None.

vi. **Identification of Differences in Shareholder's Equity as Stated in the Financial Statements Versus the Available Capital and Surplus**

Other than the impact of employing statutory-based technical provision valuation techniques, significant differences between IFRS shareholder equity and available statutory capital and surplus include the reduction in available statutory capital for goodwill and other intangible assets.

b. **Regulatory capital requirements**

i. **ECR and MSM Requirements at the End of the Reporting Period**

At the end of the reporting period, the Company's regulatory capital requirements were assessed as follows:

(Reported in thousand units)

<b><u>Requirement</u></b>	<b><u>Amount</u></b>
Minimum Margin of Solvency	\$9,387
Enhanced Capital Requirement	\$14,137

ii. **Identification of Any Non-Compliance with the MSM and the ECR**

The Company was compliant with the MSM and ECR requirement at the end of the reporting period.

iii. **A Description of the Amount and Circumstances Surrounding the Non- Compliance, the Remedial Measures and Their Effectiveness**

Not applicable.

iv. **Where the Non-Compliance is not Resolved, a Description of the Amount of the Non-Compliance**

Not applicable.

c. **Approved Internal Capital Model**

i. **Description of the Purpose and Scope of the Business and Risk Areas Where the Internal Model is Used**

Not applicable - the Company has not applied to have its internal capital model approved to determine regulatory capital requirements.

ii. **Where a Partial Internal Model is Used, Description of the Integration with the BSCR Model**

Not applicable.

iii. **Description of Methods Used in the Internal Model to Calculate the ECR**

Not applicable.

iv. **Description of Aggregation Methodologies and Diversification Effects**

Not applicable.

v. **Description of the Main Differences in the Methods and Assumptions Used for the Risk Areas in the Internal Model Versus the BSCR Model**

Not applicable.

vi. **Description of the Nature & Suitability of the Data Used in the Internal Model**

Not applicable.

vii. **Any Other Material Information**

Not applicable.

## 6. SUBSEQUENT EVENTS

With the effective date of December 19, 2016, the Company entered into a reinsurance agreement with a large national U.S. life insurance company to reinsure on a quota share basis fixed annuity contracts. The quota share percentage is 25% for the period January 1, 2017 onwards.

With the effective date of December 31, 2016, the Company entered into a binding letter of intent to execute a reinsurance agreement with a regional U.S. life insurance company to assume USD \$275,000,000 of annuity liabilities arising under deferred annuity policies written under certain policy forms. The reinsurance agreement was executed on March 1, 2017.

These transactions, will impact the Financial Condition Report, including:

- Business and performance – the Company expects earnings to increase materially.
- Risk and Capital Requirements will increase, in line with the increase in reinsurance assumed in total. Risk will be well within risk tolerance and limits and the increase in required capital will be small relative to current excess capital levels.