

ARMOUR RE

FINANCIAL CONDITION REPORT

For the period ended 31 December 2017

ARMOUR RE

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EXECUTIVE SUMMARY

Armour Re Ltd (“the Company”) is a Bermuda exempted company registered as a Class 3B insurer under the Bermuda Insurance Act 1978. The company was incorporated on 20th November, 2017 and is a wholly owned subsidiary of Armour Group Ltd.

The primary purpose of the Company is to assume, through reinsurance or investment, discontinued property and casualty business in the non-life sector of the insurance industry from insurers, reinsurers and/or other entities (including, without limitation, self-insured organisations) and to manage the payment of future claims and the assets supporting such liabilities. In furtherance of, and to the extent consistent with, the foregoing, the Company plans to (i) assume, either directly or synthetically, economic exposure to expired policies in run-off entities or blocks of discontinued property and casualty business through reinsurance, business transfer, acquisition of securities or otherwise; and (ii) acquire majority or otherwise controlling interests in property and casualty insurance, reinsurance and/or other entities in run-off, including insurance or reinsurance holding companies and/or corporate or other entities with property and casualty insurance or reinsurance liabilities.

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A. **BUSINESS AND PERFORMANCE**

a. **Name of the Insurer**

Physical Address:
Armour Re Ltd
19 Par-la-Ville Road
3rd Floor
Hamilton HM 11
Bermuda

Mailing Address:
P.O. Box HM 66
Hamilton HM AX
Bermuda

b. **Name of the Insurance Supervisor**

The Company is supervised by the Bermuda Monetary Authority.

Bermuda Monetary Authority
BMA House
43 Victoria Street
Hamilton
Bermuda

Phone: 1 441 295 5278

Lead Supervisor: Kofi Takyi
Email: ktakyi@bma.bm

As at 31st December, 2017 the Company was not designated by the BMA as a Designated Insurer for group supervision purposes as defined in the Insurance Act 1978, as amended.

c. **Approved Auditor**

The approved auditor is PricewaterhouseCoopers Ltd (Bermuda) and their contact details are as noted below:

PricewaterhouseCoopers Ltd
Washington Mall, 4th Floor
Reid Street
Hamilton
Bermuda

Phone: 1 441 295 2000

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d. Ownership Details

The Company is a wholly owned subsidiary of Armour Group Ltd.

Armour Group Ltd is owned by the following entities:

Entity	% Ownership
Trebuchet Group Holdings Limited	19.37%
Aquiline Armour Co-Invest II L.P.	11.46%
Aquiline Armour Co-Invest L.P.	44.19%
Aquiline Financial Services Fund III L.P.	24.98%

Trebuchet Group Holdings Limited (“Trebuchet”) is a privately-held company incorporated in Bermuda in 2007. The company’s activities and investments are centred in two main areas, (1) operating licensed insurance and reinsurance companies and (2) asset management. Trebuchet’s outsources its claims servicing operations to Armour Risk Management Limited and Armour Risk Management Inc.

At the end of 2017 Aquiline Holdings LLC (together with its affiliates and co-investors, “Aquiline”), acquired a majority of the voting and economic interests in Armour Group Ltd. Aquiline is a New York-based private equity firm investing in companies in the financial services (particularly insurance) and investment management industries. Aquiline seeks to add value to its portfolio companies through strategic, operational and financial guidance. Through the Aquiline Financial Services Funds, Aquiline has invested over \$2.1 billion since 2005 in 34 middle-market financial services businesses in North America and Europe. Its portfolio of companies spans the banking and credit, financial technology and services, insurance, and investment management and markets industries and includes start-ups, growth equity and buyouts, corporate carve-outs, consolidations and turnarounds.

The general partner of Aquiline Financial Services Fund III L.P. is Aquiline Capital Partners III GP (Offshore) Ltd. (the “GP”). The general partner of the GP is Aquiline Holdings (Offshore) II L.P. (“Holdings”).

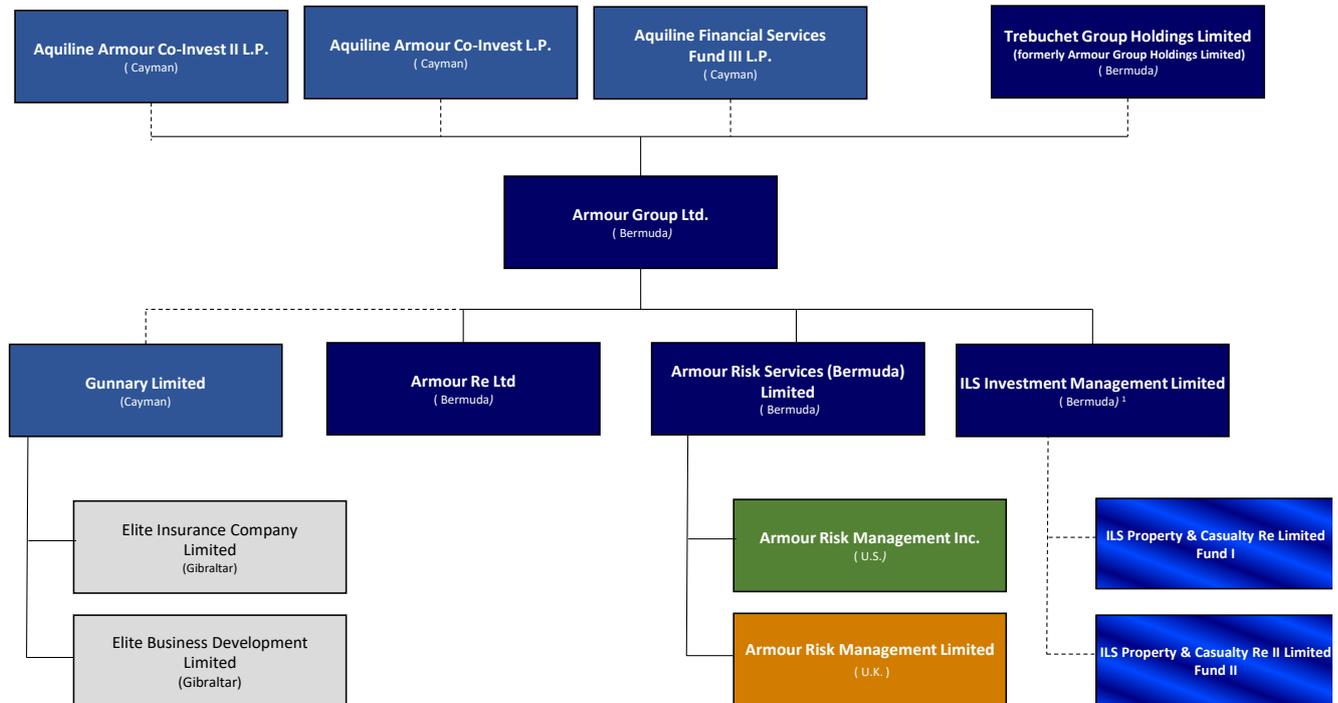
The general partner of both Aquiline Armour Co-Invest L.P. and Aquiline Armour Co-Invest II L.P. is Aquiline Co-Invest III GP Ltd. Its general partner is Holdings.

The general partner of Holdings is Aquiline Holdings GP (Offshore) Ltd., an entity controlled by Jeffrey W. Greenberg, the former chairman of Marsh & McLennan Companies, Inc.

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e. Group Structure

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



1. *ILS Investment Management Limited included here subject to regulatory and other approvals.*
2. *Gunnary Limited completed the acquisition of the Elite Insurance companies on 5 January, 2018, subsequent to year end.*

f. Insurance Business Written

On 29th December, 2017, the Company entered into a quota share retrocession agreement with ILS Property & Casualty Re II Limited which had an effective date of 31st December, 2017. The Company assumed total insurance reserves of approximately \$209.9 million. The premium receivable to the Company under the quota share agreement was approximately \$193.6 million relating to the portfolio, which primarily includes Commercial Automobile, Non-Standard Personal Automobile, General Liability, Commercial and Personal Property, Mono-line Liquor Liability, Real Estate E&O, Workers' Compensation and other smaller lines of business. On 23rd January, 2018, the Company paid \$121.1 million to ILS Property & Casualty Re II Limited, representing its proportionate share of the required collateral in order for ILS Property & Casualty Re II Limited to fully fund the contract up to its aggregate limit.

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

Performance of Investments for the Reporting Period

There were no invested assets as at 31st December, 2017.

The Company has engaged Conning Asset Management Limited, a leading international asset manager, as its initial identified investment manager. The Company anticipates that as it grows, it will work with other leading asset managers on its investment portfolio. It is expected that, in addition to core investment management and accounting services, any identified investment manager(s) will provide the Company with compliance monitoring, performance analytics and risk analytics. The Company does, however, have specialized personnel monitoring investment activities who work closely with the external investment manager.

Material Income & Expenses for the Reporting Period

There was no material income for the period from 20th November to 31st December, 2017. The table below summarises expenses:

	<u>2017</u>
	(expressed in U.S. dollars)
EXPENSES	
General and administrative expenses	\$ 236,048
TOTAL EXPENSES	<u>236,048</u>
NET LOSS AND COMPREHENSIVE LOSS	<u>\$ (236,048)</u>

h. Any Other Material Information

On 5th March, 2018, the Company entered into a quota share retrocession agreement with ILS Property & Casualty Re II Limited in relation to the loss portfolio transfer agreement ("LPTA") it entered to reinsure a portfolio of U.K. commercial motor, public and employers' liability lines of business along with property/premises related to U.K. commercial motor. Pursuant to the agreement, the Company will indemnify ILS Property & Casualty Re II Limited for the quota share percentage of the ultimate net loss and other liabilities incurred by ILS Property & Casualty Re II Limited under the LPTA. The Company has provided capital of approximately \$14.4 million to fund its quota share percentage of the aggregate limit under the terms of the LPTA.

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B. GOVERNANCE STRUCTURE

The Company has established and maintains a sound corporate governance framework with ultimate oversight being the responsibility of its Board of Directors. The Board is responsible for establishing a clear strategy that is consistent with the Company's business plan, establishing a culture that supports sound and prudent management, ensuring appropriate financial resources have been established, ensuring adequate internal controls are in place and ensuring that the Company fulfils its legal and regulatory obligations. Effective risk oversight is an important priority for the Board of Directors and the Company places a strong emphasis on establishing a robust risk management framework to identify, monitor, measure, manage and report risks that affect the achievement of its strategic, operational and financial objectives.

a. Board and Senior Executive

The Armour Re Ltd Board consists of 6 Directors of which 2 are Executive Directors, 2 are Shareholder Non-Executive Directors and 2 are Independent Non-Executive Directors. Their roles, scope, general and specific responsibilities are detailed in the Board of Directors Terms of Reference and in the Company's Bye-Laws. The parent company is Armour Group Ltd and representatives from the parent company are present on the Board to ensure alignment with corporate objectives and to provide access to Group resources where necessary. All Non-Executive Directors maintain regular dialogue with the Management Team. The Board of Directors will hold at least 4 meetings annually.

The Board has established the following committees, each of which has a charter which details the scope and key areas of responsibility for each committee:

- **Audit Committee:** The Audit Committee assists the Board of Directors in monitoring: (i) the integrity of the financial statements of the Company; (ii) the independent auditor's qualifications and independence; (iii) the performance of the Company's internal audit function and independent auditors; and (iv) compliance by the Company with legal and regulatory requirements.

- **Underwriting Committee:** The Underwriting Committee is responsible for overseeing the Board of Directors' responsibilities relating to the Company's insurance and reinsurance underwriting strategy, including the underwriting activities of the Company and accumulations and aggregations of exposures in the Company's insurance and reinsurance businesses. The Committee reviews and make recommendations to the Board of Directors regarding underwriting matters.

- **Compensation Committee:** The Compensation Committee has overall responsibility for approving, evaluating and making recommendations to the Board regarding, officer and director compensation plans, policies and programs of the Company, incentive

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compensation plans and equity compensation plans.

• **Investment Committee:** The Investment Committee is responsible for overseeing the Board of Directors' responsibilities relating to the investing affairs of the Company and recommending to the Board of Directors financial policies, strategic investments and overall investment policy, including review of manager selection, benchmarks, risk components and investment performance. In addition, the Committee reviews and makes recommendations to the Board regarding investment matters.

The Management Team consists of experienced senior run-off professionals, led by Brad Huntington and John Williams as Chief Executive Officer and President, respectively. They report to the Board of Directors.

The Management Team and the Board of Directors will receive exception reports if risk tolerances are exceeded. Importantly, any risk tolerance limit exceptions will need to be approved by the Board of Directors. If risk tolerances are exceeded, the Management Team will be required to provide the Board of Directors with a detailed plan to remediate the identified risk tolerance breached or support for the request to grant an exception.

i. Remuneration Policy

The ILS Investment Management Limited ("ILSIM") remuneration policy establishes competitive compensation levels, aligning compensation with performance. Remuneration consists of a fixed base salary and a discretionary Bonus Plan which encourages employees to strive for higher levels of job performance and to increasingly contribute to the Company's success. In addition, long-term incentive compensation, stock options and stock grants may be awarded.

Independent non-executive directors are remunerated with a fixed quarterly cash fee.

ii. Pension or Early Retirement Schemes for Members, Board and Senior Executive

The ILS Investment Management Limited provides all employees with pension benefits through a defined contribution Pension Plan ("the Plan"). Under the Plan ILSIM contributes 10% of Salary and Bonus and employees may contribute up to an additional capped percentage of salary. The Company reserves the right to modify benefits at any time during employment upon reasonable notice. The pension funds are administered by an independent third party. The Company does not have any early retirement scheme.

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iii. Material Transactions With Shareholder Controllers

There were no material transactions with shareholder controllers as at 31st December, 2017.

Fitness & Propriety

i. Fit and Proper Process

The Company recognizes the value of fit and proper requirements in that a company run in a fit and proper manner, by fit and proper directors and employees, will benefit from the knowledge and experience brought to the company and is more likely to be successful. In addition, the risks associated with a poorly run business (largely regulatory, financial or reputational risks) will be diminished.

The ultimate responsibility for sound and prudent governance and oversight of the Company rests with its Board of Directors. In determining the composition of the Board the fit-and-proper-person test has been applied in order to ensure that the following attributes are present:

- Honesty
- Integrity
- Reputation
- Competence
- Capability

ii. Board and Senior Executives - Qualifications, Skills and Expertise

Detailed below are the qualifications, skills and expertise of the Board and Senior Executives:

Brad Huntington, Chief Executive Officer and Director

Mr. Huntington has substantial experience in underwriting and asset management operations, mergers and acquisitions of insurance and reinsurance companies and the integration of operations following their acquisition. Mr. Huntington co-founded Armour Group Holdings Limited (formerly Brevan Howard P&C Partners Limited), in 2007 and is the Chairman and CEO. Prior to that, Mr. Huntington co-founded and was President and CEO of the Imagine Group, a Bermuda-based international insurance and reinsurance operation. From 2000 to 2005, Imagine Group's assets grew from an initial position of \$200 million of start-up capital and total assets to approximately \$1.9 billion in total assets and in excess of \$500 million of shareholders' equity. Prior to founding Imagine, Mr. Huntington was a consultant to Zurich Insurance Group. Prior thereto, he was a senior executive in the Centre Re group of companies, a major operating subsidiary of the Zurich Insurance Group. During his time at Centre Re he was the co-founder of their European offices and also held senior underwriting positions in their Bermuda and Zurich offices. He initially joined Centre

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Re in Bermuda as international general counsel. Mr. Huntington has also held roles as a corporate lawyer in several law firms prior to leaving private practice and was qualified as a lawyer in numerous jurisdictions including several provinces in Canada, Bermuda, England and Wales. Mr. Huntington has an MBA from INSEAD in France and BA and LLB degrees from the University of Alberta in Canada.

John Williams, President and Director

Mr. Williams has over thirty years of worldwide insurance and reinsurance industry experience. Mr. Williams co-founded Armour Group Holdings Limited (formerly Brevan Howard P&C Partners Limited), in 2007 and is the President. Prior to that, he worked as a senior underwriter at the Imagine Group from 2003 until December 2006 where he had responsibility for sourcing and structuring complex insurance transactions. He was co-founder and President of Castlewood Limited, a leading provider of run-off products for the insurance industry which he started in 1993. From 1992 until 1993 he served as a consultant on insurance and reinsurance matters to large corporations including Grumman Corp and Citigroup. Mr. Williams started his insurance career in the London market moving to Bermuda in 1981. From 1983 until 1991, Mr. Williams was the Underwriter and Vice-President of a leading reinsurer in Bermuda which was a wholly-owned subsidiary of Grumman Corp. Concurrently he held the positions of Vice-President (1983 -1988) and then Executive Vice-President and Chief Operating Officer (1988 -1991) of the reinsurer's two underwriting managers and acted as President of the affiliated consulting company. Mr. Williams currently serves on the Insurance Advisory Committee appointed by the Minister of Finance and previously served as the Chairman of the Bermuda Independent Underwriters Association and was a member of the Insurance Admissions Committee which is appointed by the Bermuda Minister of Finance. Mr. Williams was educated to 'A' level standard at Sir Joseph Williamson's Mathematical School.

Jason Rotman, Shareholder Non-Executive Director

Mr. Rotman joined Aquiline in 2008 and is co-lead of the insurance team. He is a member of the investment committee of Aquiline Technology Growth. Prior to joining Aquiline, he was with Swiss Re, where he held a variety of roles within private equity, corporate development and the insurance-linked securities businesses. He ultimately became head of alternative investments for the United States. He began his career as an analyst in the financial institutions group at Smith Barney. Mr. Rotman received a B.A. in Economics from Duke University.

Christopher Watson, Shareholder Non-Executive Director

Mr. Watson joined Aquiline in 2005 and is co-lead of the insurance team. Prior to joining Aquiline, he served in a variety of executive roles within the property and casualty insurance businesses of Citigroup and its predecessor entities. He was President and Chief Executive Officer of Gulf Insurance Group and served on the risk committee and planning group for Travelers' insurance operations. Previously, Chris served as Executive Vice-President and then President of Commercial Insurance Resources, Inc., a specialty lines insurance company subsidiary of Commercial Credit/Citigroup. Earlier in his career, he held various

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management positions at American International Group (NYSE:AIG). Mr. Watson received a B.A. from City University of New York.

Roger Gillett, Independent Non-Executive Director

Mr. Gillett has over 30 years of experience in the insurance industry at a senior level. He retired from ACE Limited in July of 2007 having joined them in November 1997 as Senior Vice-President in the Business Development department. Prior to retirement Mr. Gillett was President of ACE Risk Management International, assisting major non-U.S. corporations with their risk financing needs, including captive fronting, rent-a-captive and other sophisticated techniques. Prior to joining ACE, Mr. Gillett spent 20 years with Johnson & Higgins, most recently as a Senior Vice-President and Principal responsible for creating and developing their global captive management operations. He has served as a director of Armour Group Holdings Limited since its formation in 2007. Mr. Gillett is a frequent speaker at conferences and author of numerous published articles on Alternative Risk Financing. Mr. Gillett is a member of the Bermuda Insurance Advisory Committee and Deputy Chairman of the Insurance Development Council, a sub-committee of the Bermuda Insurance Advisory Committee. He is a past President of the Bermuda Insurance Institute and the Bermuda Insurance Managers Association. Mr. Gillett is a Fellow of the Chartered Insurance Institute and an Associate in Risk Management.

Tim Price, Independent Non-Executive Director

Timothy Price is a Director and Senior Vice-President of Raymond James Limited, the wholly-owned Canadian subsidiary of Raymond James Financial Inc., a NYSE-listed company. He was the Chairman of MacDougall, MacDougall & MacTier Inc. until its sale to Raymond James in 2016. Mr. Price worked at MacDougall since 1984 in a variety of roles, starting with management positions in finance and administration. From 1990 he has been a Portfolio Manager, and became a Director in 1992. Mr. Price assumed the position of President and Chief Executive Officer in June 2002, and served in this role until May 2009. He was named Chairman in February 2009. Prior to joining MacDougall, Mr. Price was with Coopers & Lybrand in Toronto (1980-82) and Bermuda (1982-84), and with Rowe & Pitman in London (1979-80). He has served as a Director of Armour Group Holdings Limited since its formation in 2007. He is a Chartered Accountant (1983), a Fellow of the Canadian Securities Institute (1988) and a Chartered Financial Analyst (1992). He graduated from Queen's University (Kingston, Ont.) with a Bachelor of Commerce (Honours) degree in 1979. He has served as Chair of the Investment Industry Association of Canada, the national organisation representing the Canadian Securities Industry.

Pauline Richards, Chief Operating Officer, ILS Investment Management Limited, Assistant Secretary, Armour Re Ltd.

Mrs. Richards CPA, CMA was affiliated with Aon Bermuda, a subsidiary of a major brokerage house in the United States from 1978 to 1999. Mrs. Richards held the position of Chief Financial Officer. Between 2001 and 2003 Mrs. Richards also held the position of Chief

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Financial Officer at Lombard Odier Darier Hentsch in Bermuda, the subsidiary of a well-known private Swiss banking group. From 2003 to 2008 Mrs. Richards was Director of Development at Saltus Grammar School and has been an employee of Armour Group Holdings Limited since 2008. Mrs. Richards has served on the board of public companies in the United States and Bermuda and is presently on the board of Wyndham Worldwide Corp, Apollo Global Management LLP and Hamilton Insurance Group.

Adrian Kimberley, Chief Financial Officer, ILS Investment Management Limited, Assistant Secretary Armour Re Ltd.

Mr. Kimberley is the Chief Financial Officer of ILSIM. Mr. Kimberley is an experienced (re)insurance professional having worked in the Bermuda (re)insurance market for over 22 years. Prior to joining ILSIM, Mr. Kimberley worked with Enstar Group Limited (the run-off industry's leading stand-alone company) and its affiliates for 21 years from 1995 to 2016, where he held increasingly senior positions and ultimately served as the Company's Chief Accounting Officer for nine years from 2007 to 2016. He is a member in good standing of the Chartered Professional Accountants of Bermuda and Canadian Institute of Chartered Accountants and holds a Bachelor of Commerce in Accounting from the University of British Columbia.

Lynda Leader, Senior Vice-President ILS Investment Management Limited, Assistant Secretary Armour Re Ltd.

Mrs. Leader joined ILSIM in November 2017 in the capacity of Senior Vice-President Corporate Services, with over thirty years of domestic, captive and reinsurance experience. Prior to joining ILSIM, Mrs. Leader spent 10 years at BF&M Limited, a listed Bermuda company where key responsibilities included corporate governance, company secretary, investor relations, all aspects of executive compensation and compliance. Over the 20 years prior to BF&M, Mrs. Leader worked for Coopers & Lybrand (now PricewaterhouseCoopers). Mrs. Leader then spent 13 years in the captive management division at Johnson & Higgins (now Marsh) where she progressed to the position of Senior Vice-President. From 2000 to 2006 she worked as Senior Vice-President and Director of Operations at Overseas Partners Ltd, a reinsurance company and subsidiary of UPS. Mrs. Leader is a member in good standing of the Chartered Professional Accountants of Bermuda and the Institute of Chartered Accountant in England and Wales, with a Bachelor's degree in Accounting and Finance from Middlesex University in London.

Babak Shirazi, Vice-President and Actuary, ILS Investment Management Limited

Mr. Shirazi has been working in the property and casualty actuarial field for over fourteen years. He started his actuarial career at EMB Consulting, now part of Willis Towers Watson where he worked in reserving and capital modelling. In his subsequent career he has concentrated on pricing, working for a leading global reinsurance intermediary and, more recently, at XL Insurance where he was head of one of the actuarial pricing teams. In late 2014, Mr. Shirazi joined ILSIM, with whom he previously worked with at Brevan Howard P&C Partners Limited in late 2014, to head up the Actuarial team in Bermuda. Mr. Shirazi is a Fellow of the Institute and Faculty of Actuaries and the Casualty Actuarial Society as well

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as holding a Chief Actuary practicing certificate in the United Kingdom. He holds an MSc (Hons) in Mathematics from Imperial College London (2004).

b. Risk Management and Solvency Self-Assessment
Risk Management Processes and Procedures

Armour Re Ltd. operates under conservative risk tolerances and guidelines. The Company's risk tolerances will be monitored at various levels (run-off portfolio, investment portfolio and enterprise basis). The Company has participated in two deals to date and these have been monitored to ensure compliance with claims and investment management guidelines. The Company's risk appetite considers all material risks to which the Company is exposed. The risk appetite is being established at the Company level and represents the amount of risk that the Company is willing to accept compared to risk metrics based on its capital resources, potential financial loss and other risk-specific measures. Risk levels will be monitored and it is expected that any deviations from pre-established levels will be reported in order to facilitate responsive action.

The Company's risk management framework includes a risk score matrix and the development of the Risk Register. The matrix provides a mixture of qualitative and quantitative measures with the consideration of frequency and severity to assist in the risk identification and ranking process. The Risk Register identifies and assesses key material risks. Each risk includes a detailed description, a risk owner, a listing of contributing factors, mitigating procedures and required actions, if warranted. The register will be updated on a quarterly basis and presented to the Board.

c. Internal Controls and Compliance

The Company's internal controls framework ensures that the business is being operated in an efficient and effective manner. The framework has the following components:

- The appropriate organisational structure with clear reporting lines, delegation of authority and segregation of duties;
- The Company's Governance Framework Documents, Terms of Reference for the Board of Directors and Charters for the various Committees that report to the Board ensure that an adequate system of internal controls and reporting is maintained. It further documents the responsibilities for key senior executives;
- The documentation of key policies and procedures required for the effective management of the business and operations and any authorities which are outsourced;
- Monitoring the quality of the internal controls framework in order to provide the Board of Directors with relevant information for decision-making purposes; and
- Ensuring a detailed understanding of risks taken by the Company.

The diversification and expansion of the Company's management team over time will be in accordance with sound corporate governance principles. In particular, the Board of Directors will seek to ensure the implementation of processes to ensure that the Company is appropriately independently staffed and that key employees and the Management Team

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are adequately skilled to execute and discharge their duties to ensure sound risk management and compliance.

ILS Investment Management Limited has a centralised Code of Conduct Policy which applies to its employees and directors, as well as third parties who act for the Group or on its behalf. Failure to adhere to the Policy could lead to disciplinary action, which may include termination of employment and, in some instances, could constitute the committing of a criminal offence. The Board has responsibility for establishing and communicating the standards of behaviour which all associated persons must adhere to. The Board is further responsible for ensuring that the required systems, procedures, manuals, guidelines and adequate controls are in place to ensure adherence to relevant laws and regulations and to ensure that the management of risk, and the controls in place, are monitored and regularly examined.

The Code of Conduct Policy shall be reviewed by the Compliance function at least on an annual basis. The Company is committed to allocating adequate resources to the Compliance function in order to ensure controls are effective and monitored in a manner that is appropriate and proportionate.

The Compliance function needs efficient and effective monitoring capabilities embedded in its framework; this comprises of three key elements:

- Business Operations - the measures that are incorporated into systems and processes to control day-to-day activities. There are adequate controls implemented to ensure compliance and to highlight any significant breakdown in controls or inadequacy of process. The responsibility to monitor regulatory compliance and compliance with jurisdictional laws is shared across various Group functions.
- Oversight Functions – namely the Company’s Committees and functions which oversee internal controls, including drafting and implementing policies and procedures, and monitoring compliance with them. This includes the Compliance and Risk Management functions.
- Independent Assurance Providers - The Internal Audit function and oversight of the Audit Committee. The appointment of PricewaterhouseCoopers as external auditors also provides independent assurance.

d. **Internal Audit**

The Company has an Internal Audit function, governed by the Internal Audit Charter (“the Charter”). The Charter outlines the Internal Audit framework including authority and responsibility within the organisation at Armour Re Ltd. The Charter establishes Internal Audit’s position within the organisation; authorizes access to records, personnel and physical properties relevant to the performance of engagements, and defines the scope of Internal Audit activities. The Charter ensures that the Internal Audit function performs its activities in a manner that is consistent with International Internal Audit Standards.

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The scope of the Internal Audit department's work covers all aspects of the Company's activities. This includes assessing processes, controls, systems and risk management to ensure to following:

- Risks are appropriately identified and managed.
- Interaction with the various governance groups occurs as needed.
- Significant financial, managerial and operating information is accurate, reliable and timely.
- Employees' actions are in compliance with policies, standards, procedures and applicable laws and regulations.
- Resources are acquired economically, used efficiently and adequately protected.
- Programs, plans and objectives are achieved.
- Quality and continuous improvement are fostered in the organisation's control processes.
- Significant legislative or regulatory issues impacting the organisation are recognized and addressed in a timely manner.

To provide for the independence of the Internal Audit department, the Internal Audit Manager reports administratively to the Chief Operating Officer and functionally to the Audit Committee. The department adheres to the Institute of Internal Auditors mandatory guidance including Definition of Internal Auditing, the Code of Ethics and the International Standards for the Professional Practice of Internal Auditing.

e. **Actuarial Function**

The actuarial function includes the Company's Loss Reserve Specialist and has responsibility for opining on the adequacy of the Company's reserves and managing input from third-party actuarial consultants. In addition, the actuarial function is involved in the acquisition process in terms of reviewing the adequacy of reserves and the pricing of deals.

Michael E. Mielzynski of PricewaterhouseCoopers Actuarial Services Ltd. will act as Loss Reserve Specialist. Armour Re may utilize other expert actuarial advisers on a transaction-by- transaction basis.

f. **Outsourcing**

i. **Outsourcing Policy and Key Functions that have been Outsourced**

The Group ensures that the duties, responsibilities and authorities of any third-party service provider are clearly set out in service agreements, which include terms detailing compliance with applicable laws, cooperation with the BMA and access to data and records in a timely manner. The Senior Management team is responsible for ensuring that there is a business owner for outsourced functions. The Board ensures that outsourcing arrangements do not diminish its ability to fulfil its obligations. Fundamental responsibilities such as the setting of strategies and policies and the oversight of the operation of the Company's processes are not outsourced to external third parties. Key outsourced functions include the following:

- The Claims function is managed out of the UK or U.S. by Armour Risk Management.

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- ASW Law Limited is advising the Company on Bermuda legal and regulatory matters.
- ILS Investment Management Limited, being a member Group company, undertakes finance, treasury, corporate governance, risk management, compliance and actuarial services pursuant to a management services agreement. Armour Re Ltd maintains all of its books of account and related records at its principal office in Bermuda, which includes maintaining all of the statutory records prescribed by the Insurance Act.
- U.S. legal, tax and regulatory matters are outsourced to outside counsel.

C. **RISK PROFILE**

The Company believes that a strong, effective and embedded risk management framework is crucial to the success of the business. The Company aims to achieve this goal through a culture of strong risk management principles.

a. **Risk Profile**

The Company's Risk Management function supports the identification, measurement, management, monitoring and reporting of the all major risks to which the Company is exposed. The Company's Risk Profile is a point in time measurement of the risks that the Company is exposed to. The Company was incorporated on 20 November, 2017 and was granted its Class 3B insurance license on 15 December, 2017. The Company wrote its one and only insurance contract on 31 December, 2017. Consequently, the evaluation of the Company's risk profile for the year end 31 December 2017 is limited to the one transaction concluded during the period.

The Company has identified the following material risks, namely:

- Credit Risk;
- Reserve Risk; and
- Operational Risk

i) **Credit Risk**

Credit risk arises from the exposure to premiums receivable under the single quota share agreement entered into on 31 December, 2017.

ii) **Reserve Risk**

Reserve risk arises from adverse reserve development through failing to set sufficient cash reserves or through failing to adopt a robust reserve strategy. It represents the difference between the actual versus expected variability in the timing and amount of loss costs including indemnity, legal and loss adjustment expenses.

iii) **Operational Risk**

Operational risk is the risk of a loss arising from inadequate or failed internal processes, or from external events, personnel, systems or third parties.

b. **Measurement and Assessment**

The Company has undertaken an assessment of the full impact of its risk exposures for the year ended 31 December 2017. The most significant credit risk relates to premiums receivable under the quota share agreement amounting to \$193.6 million and was contractually due on 23 January, 2018. The full amount was received and paid into premium trust accounts on this date, thereby eliminating the 2017 year-end credit risk assessment.

The exposure to reserve risk arises from property, casualty and U.S. professional lines of business. However, should a credit event occur the resulting implication would be to effectively eliminate the assessed reserve risk as the contract would be cancelled as a result of non-payment of the premium and therefore no reserves would be assumed by the Company.

The Company strives to mitigate operational risk through the application of its policies and procedures and internal control and compliance processes. The performance of third parties are monitored and evaluated against service agreements.

c. **Material Risk Concentrations**

All business deals that Armour Re Ltd. enters into require the approval of its Underwriting Committee. The Committee has responsibility for managing the accumulations and aggregation of exposures in the Company's business and ensuring that there is no exposure to unreasonable concentrations.

The risk profile of the Company is expected to change in future as new business is underwritten. A detailed risk assessment will be performed to address additional exposures. These procedures will be formally documented and subjected to risk evaluations and mitigation procedures. All identified risks will be included in the Risk Register.

D. SOLVENCY VALUATION

The Company is in the process of establishing a policy and detailed procedures to perform, at least annually, an assessment of the amount of capital it requires to achieve its strategic goals upon undertaking an assessment of all material (reasonably foreseeable) risks arising from its operations and operating environment.

The assessment will be performed with the following aims in mind, namely:

- Strategic Planning
- Defining the Company's risk appetite

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- Evaluation of capital adequacy
- Allocation of capital to business segments and lines of business
- Capital Management
- Determination of investment policies and strategies
- Meeting regulatory requirements
- Improving merger and acquisition decisions

The results of these internal assessment procedures will be formally documented, presented and considered by the Board on an annual basis in order to assess capital and solvency management as part of its broader corporate strategy.

The Company has undertaken to use the regulatory capital as a proxy for its self-assessment of capital in 2017, the first year of operations of the Company. The Company wrote its one and only 2017 insurance contract on 31 December, 2017. Based on there being only one transaction during the year, the Company believes this approach to be appropriate in assessing its solvency and capital requirements for the 2017 year. The Company's capital requirement for 2017 is capped at the aggregate limit of the loss portfolio reinsurance contract it entered into on 31 December, 2017. As the only contract entered into has been fully funded to its aggregate limit, any required capital assessment will be superseded by the collateral requirements under the contract. The Company will be considering its self-assessment of capital and solvency in the future as further contracts are underwritten in order to assess the overall protection of policyholders and its internal strategy.

E. CAPITAL MANAGEMENT

The Company strives to maintain sufficient and appropriate levels of capital to meet its financial obligations and to achieve its strategic goals.

The Company's capital comprises the following, namely:

- Own Funds; and
- Solvency Capital Requirement ("SCR") and Minimum Capital Requirement ("MCR")

a) Own Funds

The Company's Own Funds are comprised of items on its balance sheet, which are referred to as basic own funds and off balance sheet items that may be called up to absorb losses, referred to as ancillary own funds.

Composition of Own Funds

Tier 1 basic own funds includes the Company's Share Capital (\$0.12 million) and Additional Paid-in Capital (\$122.1 million). The Company has no other own funds.

It is, however, important to note the terms of the single insurance contract entered into by the Company as at 31 December. The Company's capital requirement for 2017 is capped at the aggregate limit of the loss portfolio reinsurance contract it entered into on 31 December, 2017. The Company, as part of the reinsurance agreement, agreed to post collateral so as to fully fund

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the contract up to its aggregate limit. As the funding date for the payment of the collateral was subsequent to year-end there was no risk associated with the value of the cash and investments as at year-end. However, in subsequent years the risk would be that the market value of the assets decline leaving the contract without full collateralization. If in the future the contract does not have the required assets to meet its collateralization requirements the Company would draw on available committed capital from its parent to provide the required additional assets for collateral funds. Consequently, the ability to call up additional funds creates the availability of ancillary own funds upon which the Company can call up.

b. Solvency Capital Requirement (“SCR”) and Minimum Capital Requirement (“MCR”)

The SCR is the amount of funds that the Company is required to hold in line with the Solvency II Directive. The SCR calculation is a formula-based figure calibrated to ensure that all quantifiable risks are taken into account.

The calculation resulted in a SCR of \$81.5 million comprising of the following:

Market Risk Charge of \$0.2 million
Add: Credit Risk Charge of \$6.1 million
Add: Reserve Risk Charge of \$64.6 million
= Basic SCR (prior to correlation adjustment) of \$70.9 million

Less: Correlation adjustment of \$3.0 million
Add: Operational Risk Charge of \$13.6 million

= SCR (after correlation adjustment) of \$81.5 million

The Company uses the standard formula to calculate its MCR. The amount of the MCR for the reporting period is \$31.5 million.

Capital Management Plan

Capital management is focussed on ensuring that the Company has sufficient coverage to meet its regulatory SCR and MCR, as well as addressing its wider strategic capital targets.

The Company will produce an annual Capital Management Plan (“the Plan”) which sets out target capital parameters and strategy to ensure regulatory and company-specific capital needs and targets are met. The Plan will be approved by the Board and will be maintained over a three year business planning horizon.

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DECLARATION

To the best of our knowledge and belief, the Financial Condition Report fairly represents the financial condition of Armour Re Ltd in all material aspects as at 31st December, 2017.

John Williams

President

Armour Re Ltd.

Adrian Kimberley

Chief Financial Officer

Armour Re Ltd.