GROUP FINANCIAL CONDITION REPORT
FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2020

Issue Date: 31 May 2021

FINANCIAL CONDITION REPORT

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INTRODUCTION

Watford Holdings Ltd. and its subsidiaries ("Watford" or "the Group" or "WHL" or "we" or "our") is a global insurance and reinsurance group regulated by the Bermuda Monetary Authority (the "BMA") in Bermuda. Watford writes business through its wholly owned subsidiaries of Watford Re Ltd ("WRL"), Watford Specialty Insurance Company ("WSIC") and Watford Insurance Company ("WIC") and Watford Insurance Company Europe Limited ("WICE"). In March 2014, WHL raised $1.1 billion for its initial funding, and began underwriting reinsurance in the first half of 2014.

Our strategy combines a diversified, casualty-focused underwriting portfolio, accessed through our strategic relationship with Arch Capital Group Ltd. and its subsidiaries ("Arch"), with disciplined investment strategies comprising primarily non-investment grade corporate credit assets, managed by HPS Investment Partners LLC ("HPS"). We have designed our investment strategies to complement the characteristics of our underwriting portfolios in order to generate attractive risk-adjusted returns for our shareholders.

In 2019, the Company entered into an agreement to acquire Axeria IARD, a property and casualty insurance company based in France. The Company committed to acquiring 100% of the capital stock of Axeria IARD from the APRIL group. The transaction was completed on April 9, 2021.

On October 9, 2020, we entered into an Agreement and Plan of Merger with Arch and Greysbridge Ltd., or Merger Sub, pursuant to which, among other things, Merger Sub will merge with and into our company. Further, on November 2, 2020, we entered into Amendment No. 1 to the Agreement and Plan of Merger with Arch and Merger Sub, and Arch assigned its interests and obligations under the Merger Agreement to Greysbridge Holdings Ltd., a newly formed entity, or HoldCo, of which Arch will own approximately 40%, and funds managed by Warburg Pincus LLC and Kelso & Company will each own approximately 30%. Arch remains contractually responsible for the performance of its obligations under the Merger Agreement.

We and our operating subsidiaries all carry a financial strength rating of "A-" (Excellent) from A.M. Best Company, or A.M. Best, which is the fourth highest of 15 ratings that A.M. Best confers. Each of our operating subsidiaries also carry a financial strength rating of "A" with a stable outlook from Kroll Bond Rating Agency, or KBRA, which is the 6^{th} highest of 22 ratings that KBRA confers.

Commentary, results and financial information presented herein reflect both WHL and those of WRL, on a consolidated basis. Where differences between WHL and WRL are relevant separate analysis has been provided. Such differences relate entirely to eligible capital amounts.

SECTION A – BUSINESS AND PERFORMANCE

Name of the Designated Insurer

Watford Re Ltd.
Waterloo House, 1st Floor
100 Pitts Bay Road
Pembroke, HM 08
Bermuda

Insurance and Group Supervisor:

Bermuda Monetary Authority
BMA House
43 Victoria Street
Hamilton, HM 12
Bermuda

Approved Auditor

PricewaterhouseCoopers Ltd.
Washington House
4th Floor
16 Church Street
Hamilton HM 11
Bermuda

Ownership details

In the first quarter of 2014, WHL raised approximately $1.1 billion of capital consisting of $907.3 million in common equity and $226.6 million in preferred equity. Through its wholly-owned subsidiary, Arch Reinsurance Ltd. ("ARL"), Arch invested $100.0 million and acquired approximately 11% of the Company's common equity. Due to share repurchase activities undertaken during 2019 and 2020, Arch's ownership percentage stands at 12.6% at December 31, 2020.

On October 9, 2020, we entered into an Agreement and Plan of Merger with Arch and Greysbridge Ltd., or Merger Sub, pursuant to which, among other things, Merger Sub will merge with and into our company. Further, on November 2, 2020, we entered into Amendment No. 1 to the Agreement and Plan of Merger with Arch and Merger Sub, and Arch assigned its interests and obligations under the Merger Agreement to Greysbridge Holdings Ltd., a newly formed entity, or HoldCo, of which Arch will own approximately 40%, and funds managed by Warburg Pincus LLC and Kelso & Company will each own approximately 30%. Arch remains contractually responsible for the performance of its obligations under the Merger Agreement.

On February 16, 2021, ARL sold an aggregate of 230,400 common shares to affiliates of Kelso & Company ("Kelso") and 230,400 common shares to an affiliate of Warburg Pincus LLC

("Warburg Pincus"), in each case, at a purchase price of $34.66 per common share, which was the then current market price of the common shares, based on the closing sale price of the common shares on the Nasdaq Global Select Market on February 12, 2021 (such sales collectively, the "Arch Sales"). Subsequent to the Arch Sales, ARL held approximately 10.3%, a decrease from 12.6% as of December 31, 2020, of the Company's issued and outstanding common shares. In connection with the Arch Sales, on February 16, 2021, the Company entered into a waiver to the Arch Voting Agreement with ARL and Gulf Reinsurance Ltd. in order to permit the Arch Sales to Kelso and Warburg Pincus.

All entities of the Group are 100% owned by their respective parent. Please refer to Appendix 1 for an overview of the corporate structure.

Insurance Business Written (figures provided are US GAAP)

The Group writes insurance and reinsurance specialty lines on a worldwide basis. Product lines include: (i) casualty reinsurance; (ii) property catastrophe reinsurance; (iii) other specialty lines reinsurance (consisting of mortgage, other specialty lines, property excluding property catastrophe, marine and aviation and other lines); and (iv) insurance programs and coinsurance (consisting primarily of casualty, other specialty, and property excluding property catastrophe).

Gross premiums written were $728.5 million for the year ended December 31, 2020 compared to $754.9 million for the year ended December 31, 2019, a decrease of $26.4 million, or 3%. The decrease primarily related to decreases in casualty reinsurance and other specialty, which were offset in part by increases in insurance programs and coinsurance as well as property catastrophe reinsurance.

Our casualty reinsurance gross premiums decreased by $91.9 million over the prior year, or 32.8%, to $188.0 million. The premium decrease in casualty reinsurance was driven by an $81.1 million, three-year excess of loss contract written in 2019, with no comparable premium written during the current period. In addition, there were non-renewals and reduced participation in 2019 and 2020 on certain workers' compensation professional liability, and multi-line treaties.

Our insurance programs and coinsurance line of business gross premiums written increased by $56.8 million over the prior year, or 16.8%, to $396.0 million. The premium growth was driven by the continued expansion of our U.S. and European platforms. During the year ended December 31, 2020, the U.S. business collectively grew its insurance programs' gross premiums written by $41.5 million, or 33.4%, to $165.7 million. Premium growth in the United States was driven by increased writings for commercial auto, where we are seeing significant rate improvement. In addition, during the year ended December 31, 2020, our European business increased its insurance gross premiums written by $15.3 million, or 7.1%, to $230.3 million, primarily due to increased U.K. motor and multi-line writings.

	Year Ended December 31,		
	2020	2019	2018
		($ in thousands)	
Gross premiums written:			
Casualty reinsurance	$ 188,042	$ 279,967	$ 274,661
Other specialty reinsurance	117,177	119,518	196,170
Property catastrophe reinsurance	27,334	16,226	10,424
Insurance programs and coinsurance	395,993	339,170	253,760
Total	$ 728,546	$ 754,881	$ 735,015
Net premiums written:			
Casualty reinsurance	$ 185,968	$ 225,758	$ 273,048
Other specialty reinsurance	111,575	114,876	181,096
Property catastrophe reinsurance	26,587	15,517	10,193
Insurance programs and coinsurance	213,459	176,711	139,838
Total	$ 537,589	$ 532,862	$ 604,175
Net premiums earned:			
Casualty reinsurance	$ 205,192	$ 238,437	$ 278,656
Other specialty reinsurance	131,873	149,688	162,691
Property catastrophe reinsurance	23,037	13,399	10,998
Insurance programs and coinsurance	200,249	155,166	126,517
Total	$ 560,351	$ 556,690	$ 578,862
Net premiums written by underwriting location:			
United States	$ 115,471	$ 127,176	$ 49,800
Europe	97,753	52,065	91,635
Bermuda	324,365	353,621	462,740
Total	$ 537,589	$ 532,862	$ 604,175

Investment Performance (figures provided are US GAAP)

The components of our net investment income (loss) for the years ended 31 December 2020, 2019, and 2018 were as follows (in thousands):

	Year Ended December 31,		
	2020	2019	2018
	($ in thousands)		
Interest income	$ 140,390	$ 163,888	$ 152,916
Investment management fees - related parties	(17,193)	(18,392)	(17,006)
Borrowing and miscellaneous other investment expenses	(16,807)	(29,285)	(28,377)
Net interest income	106,390	116,211	107,533
Net realized gains (losses) on investments	12,217	(7,948)	(4,788)
Net unrealized gains (losses) on investments	7,412	32,191	(109,046)
Investment performance fees - related parties	(12,037)	(12,191)	(48)
Net investment income (loss)	113,982	128,263	(6,349)
Net interest income yield on average net assets (1)	5.1 %	5.4 %	5.4 %
Non-investment grade portfolio (1)	6.7 %	6.8 %	7.0 %
Investment grade portfolio (1)	1.6 %	2.5 %	1.9 %
Net investment income return on average net assets (1)	5.4 %	6.0 %	(0.3)%
Non-investment grade portfolio (1)	6.5 %	6.8 %	(0.2)%
Investment grade portfolio (1)	3.0 %	3.9 %	0.9 %
Net investment income return on average total investments (excluding accrued investment income) (2)	4.4 %	4.6 %	(0.2)%
Non-investment grade portfolio (2)	5.3 %	5.7 %	(0.1)%
Investment grade portfolio (2)	3.0 %	3.9 %	0.9 %

(1) Net interest income yield on average net assets and net investment income return on average net assets are calculated by dividing net interest income, and net investment income (loss), respectively, by average net assets. Net assets is calculated as the sum of total investments, accrued investment income and receivables for securities sold, less revolving credit agreement borrowings, payable for securities purchased and payable for securities sold short. For the twelve-month period, average net assets is calculated using the averages of each quarterly period. However, for the investment grade portfolio component of these returns, the impact of the revolving credit agreement borrowings is not subtracted from net interest income, net investment income (loss), or the net assets calculation. The separate components of these returns (non-investment grade portfolio and investment grade portfolio) are non-U.S. GAAP financial measures. Refer to "-Reconciliation of non-U.S. GAAP financial measures" for a reconciliation of these components of our net interest income yield on average net assets and net investment income return on average net assets.

(2) Net investment income return on average total investments (excluding accrued investment income) is calculated by dividing net investment income by average total investments. For the twelve-month period, average total investments is calculated using the averages of each quarterly period. However, for the investment grade portfolio component of these returns, the impact of revolving credit agreement borrowings is not subtracted from net investment income. The separate components of these returns (non-investment grade portfolio and investment grade portfolio) are non-U.S. GAAP financial measures. Refer to "-Reconciliation of non-U.S. GAAP financial measures" for a reconciliation of these components of our net investment income return on average total investments (excluding accrued investment income).

The investment performance for 2020 is broken down into the following asset classes:

	Year Ended December 31, 2020			
	Net Interest Income	Net Unrealized Gains (Losses)	Net Realized Gains (Losses)	Net Investment Income (Loss)
	($ in thousands)			
Net investment income (loss) by asset class:				
Term loan investments	$ 76,157	$ 11,821	$ (16,495)	$ 71,483
Fixed maturities - Fair value option	42,431	(5,834)	12,563	49,160
Fixed maturities - Available for sale (1)	13,805	—	10,624	24,429
Short-term investments	5,377	46	580	6,003
Equities (2)	—	11,042	198	11,240
Equities, fair value through net income (2)	951	(5,602)	(1,149)	(5,800)
Other investments	1,669	(1,788)	5,521	5,402
Other (3)	—	(2,273)	375	(1,898)
Investment management fees - related parties	(17,193)	—	—	(17,193)
Borrowing and miscellaneous other investment expenses	(16,807)	—	—	(16,807)
Investment performance fees - related parties	—	—	—	(12,037)
	$ 106,390	$ 7,412	$ 12,217	$ 113,982

(1) Net realized gains (losses) from the fixed maturities available for sale portfolio consists of realized gains and realized losses of $14.6 million and $4.0 million, respectively. Realized losses include an allowance for expected credit losses on available for sale securities of $0.2 million for the year ended December 31, 2020.

(2) Net interest income includes dividends for securities held in long and short positions.

(3) Other includes unrealized gains and unrealized losses for total return swaps.

Net investment income was $114.0 million for the year ended December 31, 2020 compared to net investment income of $128.3 million in the prior year, a decrease of $14.3 million. For the year ended December 31, 2020, the net investment income return on average net assets was 5.4% as compared to 6.0% in the prior year.

Net investment income for the year ended December 31, 2020 included net interest income of $106.4 million, which decreased 8.5% from the prior year. The net interest income decrease over the prior year reflected a gradual shift to higher rated investments in our non-investment grade portfolio, a reduction in LIBOR and its impact on our investments in floating rate securities, and a reduction in prevailing interest rates during the current year. Additionally, net realized and unrealized gains of $19.6 million contributed to net investment income.

The non-investment grade portfolio net interest income for the year ended December 31, 2020 was $99.4 million, compared to net interest income of $107.4 million, in the prior year, a decrease of $8.0 million. The decrease was attributable to a gradual shift to higher rated, lower yielding investments in our non-investment grade portfolio and a reduction in LIBOR and its impact on our investments in floating rate securities. Net investment income return on average net assets was 6.5% for the year ended December 31, 2020, compared to 6.8% in the prior year. The decrease was driven by a reduction in net interest income and a reduction in net realized and unrealized gains for the year ended December 31, 2020.

The investment grade portfolio net interest income yield for the year ended December 31, 2020 was 1.6%, a decrease from 2.5% in the prior year. The reduction in net interest income yield was driven by a reduction in LIBOR and its impact on our investments in floating rate securities, and a reduction in prevailing interest rates during the current year.

The investment grade portfolio net interest income decrease also reflected a reduction in net invested assets, due to collateral management actions taken during 2020. These actions resulted in $11.0 million of net realized gains. We sold certain assets that were held in collateral trust as the collateral requirements had changed and given the positive interest rate movements in the year, these assets realized net gains on disposal.

Material Income & Expenses (figures provided are US GAAP)

The following table summarizes the Group's revenues and expenses for 2020, 2019 and 2018.

	Year Ended December 31,		
	2020	2019	2018
Revenues			
Gross premiums written (1)	$ 728,546	$ 754,881	$ 735,015
Gross premiums ceded (1)	(190,957)	(222,019)	(130,840)
Net premiums written (1)	537,589	532,862	604,175
Change in unearned premiums (1)	22,762	23,828	(25,313)
Net premiums earned (1)	560,351	556,690	578,862
Other underwriting income (loss)	2,045	2,412	2,722
Interest income	140,390	163,888	152,916
Investment management fees - related parties (1)	(17,193)	(18,392)	(17,006)
Borrowing and miscellaneous other investment expenses	(16,807)	(29,285)	(28,377)
Net interest income	106,390	116,211	107,533
Realized and unrealized gains (losses) on investments	19,629	24,243	(113,834)
Investment performance fees - related parties (1)	(12,037)	(12,191)	(48)
Net investment income (loss)	113,982	128,263	(6,349)
Total revenues	676,378	687,365	575,235
Expenses			
Loss and loss adjustment expenses (1)	(440,482)	(453,135)	(441,255)
Acquisition expenses (1)	(125,541)	(126,788)	(141,136)
General and administrative expenses (1)	(28,341)	(30,843)	(22,311)
Interest expense (1)	(11,647)	(5,791)	—
Net foreign exchange gains (losses)	(1,387)	(8,247)	3,611
Transaction costs and other	(4,040)	—	—
Non-recurring direct listing expenses	—	—	(9,000)
Total expenses	(611,438)	(624,804)	(610,091)
Income (loss) before income taxes	64,940	62,561	(34,856)
Income tax expense	(26)	(20)	(27)
Net income (loss) before preference dividends and redemption costs	64,914	62,541	(34,883)
Preference dividends (1)	(4,402)	(13,632)	(19,633)
Accelerated amortization of costs related to the redemption of preference shares (1)	—	(4,164)	—
Net income (loss) available to common shareholders	$ 60,512	$ 44,745	$ (54,516)
Earnings (loss) per common share:			
Basic	$ 3.04	$ 2.00	$ (2.40)
Diluted	$ 3.04	$ 2.00	$ (2.40)
Weighted average number of common shares used in the determination of earnings (loss) per share:			
Basic	19,899,137	22,366,682	22,682,875
Diluted	19,921,231	22,373,968	22,682,875

Any other material information

The outbreak of COVID-19 began significantly impacting the U.S. and global markets during the 2020 first quarter and the pandemic continued to cause unprecedented economic volatility and disruption globally throughout 2020. We remain committed to the safety of our employees, including restricting travel and instituting a work from home policy. These actions have helped prevent a major disruption to our operations or our ability to service our clients.

We believe that we are relatively less exposed to COVID-19 global pandemic-related underwriting losses than many industry peers. For example, we have either no, or de minimis, premium writings in life, accident and health, event cancellation, trade credit, travel or pandemic specific coverages that respond directly to COVID-19 global pandemic-related losses. With regard to the potential exposure to business interruption losses, we write a limited amount of commercial property exposure, mainly emanating from our property catastrophe line of business. We reserved $5.5 million in 2020 for COVID-19 global pandemic related business interruption losses in our property catastrophe lines of business. We continue to monitor our potential COVID-19 global pandemic exposures across all our lines of business, including U.S. mortgage, workers' compensation, professional liability and medical malpractice.

Despite positive earnings in our non-investment grade strategy, we have reduced our exposure to this strategy by reducing the assets in our non-investment grade portfolio throughout 2020. This reduction was a result of both the COVID-19 induced mark-to-market volatility we experienced on our non-investment grade investments in the first quarter of 2020, as well as the fact that credit spreads tightened through the year reducing attractive opportunities to deploy our capital in this strategy. Year over year, we have reduced our non-investment grade portfolio's net assets by approximately $100 million and the total investments excluding short term investments by over $200 million.

There is no other material information in regards to the Group's business and performance that has not been included above.

SECTION B – OVERVIEW OF GROUP STRUCTURE AND BUSINESS

Board and Senior Executives

Watford maintains an effective system of governance, which provides for sound and prudent management of the integrated operations. Watford has designed its system of governance to achieve an adequately transparent organizational structure that has well-defined, clear, consistent and documented lines of responsibility across the Group as well as ensuring personnel have the skills, knowledge and expertise necessary to properly discharge their assigned responsibilities. This allows Watford to establish and maintain processes to achieve effective internal reporting and communication of information at all relevant levels within the integrated operations.

Watford is managed under the direction of eight directors. The Board is responsible for ensuring that there is an appropriate business strategy, effective governance, appropriate financial resources and adequate internal controls. Reporting to the Board of Directors are the following committees:

1) Audit Committee (Chaired by Mr. Thomas Miller)
2) Compensation Committee (Chaired by Mr. Walter Harris)
3) Governance and Nominating Committee (Chaired by Ms. Deborah DeCotis)
4) Investment Committee (Chaired by Ms. Betsy Gile)
5) Risk Committee (Chaired by Mr. Garth Lorimer Turner)
6) Strategy Committee (Chaired by Mr. John Rathgeber (until October 2020); Mr. Jon Levy)
7) Underwriting Committee (Chaired by Mr. Maamoun Rajeh)

Each committee has a charter which identifies the scope, authority and responsibilities of the committee.

Fitness and Propriety Requirements

The Nominating and Governance Committee assists the Board by identifying individuals qualified to become Board members and recommends to the Board the nominees for directorship for the next annual meeting of shareholders. All prospective employees undergo a diligence and interview process by members of the Watford executive management team. In addition, new hires with the level of Vice President or above require approval by the Board. An annual performance management process is undertaken in accordance with established policies approved by the Board. Additionally, the Board undertakes a self-assessment to determine the effectiveness of the Board and its committees.

The governance structure and composition of the Board and Committee's is consistent at both the Group and WRL level. Board and senior executives are outlined below:

Jon Levy, Chief Executive Officer, President and Director. Mr. Levy has served as our Chief Executive Officer since April 1, 2020 and as our President since February 2018. He was appointed as a member of Watford's board of directors on May 22, 2020. In addition, from March 2014 to January 2020, he served as our Chief Risk Officer. Mr. Levy has over 20 years of insurance experience, most recently with Endurance Specialty Holdings Ltd., where he worked from July 2008 to March 2014, most recently serving as Senior Vice President and Chief Pricing Actuary of Global Insurance. His prior roles within Endurance include Chief Pricing Actuary of Bermuda Insurance, after joining Endurance in 2008 as its Corporate Actuary. Prior to Endurance, Mr. Levy was a Senior Consultant at Tillinghast Towers Perrin where he provided consulting services for domestic and international insurers and reinsurers. Prior to Tillinghast, Mr. Levy spent five years with ACE INA in Philadelphia. Mr. Levy holds an A.B. from Lafayette College. He is also a Fellow of the Casualty Actuarial Society and a member of the American Academy of Actuaries.

Watford believes Mr. Levy's qualifications to serve on Watford's board of directors include his many years of insurance and reinsurance industry executive-level leadership and underwriting experience, as well as his actuarial expertise.

Mr. Levy sits on the Investment, Underwriting, Strategy and Risk committees.

Walter Harris, Chairman of the Board and Director. Mr. Harris has served as Watford's Chairman of the Board since March 2014. Since October 2014, Mr. Harris has been President and Chief Executive Officer of FOJP Service Corporation, a provider of insurance and risk management advisory services to major healthcare organizations, and President and Chief Executive Officer of Hospitals Insurance Company, Inc., a provider of medical professional liability insurance to physicians and hospitals. Before joining FOJP Service Corporation and Hospitals Insurance Company, Mr. Harris served as Senior Advisor and Vice Chairman Emeritus to Alliant Insurance Services, Inc., one of the largest insurance brokerage firms in the United States from December 2010 to May 2013. Prior to joining Alliant, he served as Chairman and Chief Executive Officer of T&H Group, one of the largest privately held insurance brokerage firms in the United States, from 1980 until its acquisition by Alliant in 2010. Mr. Harris has also served as an advisor to investors in insurance entities as well as special counsel to several major insurance coverage litigations. He is currently a director of Loews Corp. and chairman of its audit committee. Mr. Harris received a B.A. from Stanford University, a J.D. from the University of California, Berkeley and an LLM in Taxation from the N.Y.U. School of Law.

Watford believes Mr. Harris's qualifications to serve on Watford's board of directors include his extensive background in the insurance industry, substantial board experience and his broad strategic and operational leadership.

Mr. Harris sits on the Investment, Underwriting, Audit, Strategy, Nominating and Compensation committees.

Nicolas Papadopoulo, Director. Mr. Papadopoulo has served as a Watford director since March 2014. Mr. Papadopoulo is President and Chief Underwriting Officer of Arch Capital Group Ltd. and CEO of Arch Worldwide Insurance Group. He was promoted to his current position on January 1, 2021. From September 2017 to December 2020, Mr. Papadopoulo was Chairman and Chief Executive Officer of Arch Worldwide Insurance Group and Chief Underwriting Officer for Property and Casualty Operations. From July 2014 to September 2017, Mr. Papadopoulo was Chairman and Chief Executive Officer of Arch Reinsurance Group at Arch Capital. Mr. Papadopoulo joined Arch Reinsurance Ltd. in December 2001 as Senior Global Property Underwriter. Prior to joining Arch Reinsurance Ltd., he held various positions at Sorema N.A. Reinsurance Group, a U.S. subsidiary of Groupama S.A., a Paris-based global insurance group, from 1990, including Executive Vice President and Chief Underwriting Officer beginning in 1997. Prior to 1990, Mr. Papadopoulo was an insurance examiner with the Ministry of Finance, Insurance Department, in France. Mr. Papadopoulo graduated from École Polytechnique in France in 1986 and École Nationale de la Statistique et de l'Administration Économique in France with the French equivalent of a Ph.D. in 1989. He is also a member of the International Actuarial Association and a fellow at the French Actuarial Society.

Watford believes Mr. Papadopoulo's qualifications to serve on Watford's board of directors include his many years of executive-level reinsurance industry leadership, his deep insurance and reinsurance industry underwriting experience as well as his actuarial expertise.

Mr. Papadopoulo sits on the Investment and Strategy committees.

Thomas Miller, Director. Mr. Miller has served as our director since May 2017. Mr. Miller retired from PricewaterhouseCoopers Bermuda in 2016, having been with the firm since 1984, where he served a wide variety of financial services and specifically insurance and reinsurance company clients. He became a partner of Coopers & Lybrand in 1991 and was managing partner of the firm at the time of the merger with Price Waterhouse in 1998 and was joint managing partner of the merged PwC firm until 2003. Mr. Miller lives in Bermuda and has served on the boards of a number of Bermuda organizations including Bermuda Government's Audit Committee and The Bermuda Institute of Chartered Accountants. Mr. Miller obtained his professional designation as a Chartered Accountant in 1981. He received his Bachelor of Commerce from Queen's University, Kingston Ontario, and holds the professional designation of FCPA.

Watford believes Mr. Miller's qualifications to serve on our board of directors includes his extensive experience and expertise in public accounting for public and private financial services companies as well as his general business acumen.

Mr. Miller sits on the Audit and Nominating committees.

Garth Lorimer Turner, Director. Mr. Lorimer Turner has served as a Watford director since March 2014. Mr. Lorimer Turner currently serves as Co-Founder and Director of Cohort Limited, a Bermuda company founded in July 2012 which provides corporate management and consultancy services to offshore companies and funds and acts as a Trading Member of the Bermuda Stock Exchange. From August 2001 to July 2012, Mr. Lorimer Turner served as Managing Director of Jupiter Asset Management (Bermuda) Limited, a wholly-owned subsidiary of Jupiter Fund Management Plc, a leading U.K. fund management group listed on the London Stock Exchange with products that range from unit trusts to investment companies and offshore funds. Mr. Lorimer Turner received an LL.B. from the University of Southampton, England and Law Society Finals from the College of Law at Lancaster Gate in London. Mr. Lorimer Turner is a qualified lawyer in England & Wales and Hong Kong and a Bermuda qualified barrister and attorney.

Watford believes Mr. Lorimer Turner's qualifications to serve on Watford's board of directors include his extensive experience in the investment and broader financial services industries and his general financial and business acumen, all of which have provided him with significant expertise relevant to Watford's business model which combines insurance and reinsurance underwriting with an investment strategy designed to complement Watford's target business mix.

Mr. Lorimer Turner sits on the Audit, Risk and Compensation committees.

Deborah DeCotis, Director. Ms. DeCotis has served as a Watford director since 2017. She is a retired Morgan Stanley Managing Director, and is active on various professional and philanthropic boards. Currently she serves as director on both Allianz Global Investors Capital LLC – Multi-Fund Board and the PIMCO Closed-End Funds Board. Her prior professional experience also includes being a director and member of the Audit and Governance Committee for Armor Holdings, a manufacturer of military-grade safety equipment. She served as Lead Director during the sale of Armor to BAE. Prior to Armor she was an executive vice-president for Sotheby Holdings, Inc. Outside of the professional realm she is a member of Circle Financial Group and the Council of Foreign Relations. She also recently ended her term as a trustee on the board of Stanford University, where she previously served on the Advisory Council of Stanford Business School and was trustee and Chair of the Stanford Business School Trust where she was a recipient of the John W. Gardner Volunteer Leadership Award. In addition, Ms. DeCotis completed her ten year term as co-Chair of the Special Projects Committee at Memorial Sloan Kettering Hospital, having served on that Committee for 28 years. Ms. DeCotis holds a BA in Mathematics from Smith College and an MBA from the Stanford Graduate School of Business, from which she graduated with distinction as a Miller Scholar (top 10% of the class).

Watford believes Ms. DeCotis' qualifications to serve on our board of directors include her many years of executive-level investment industry leadership, and her broad governance experience.

Ms. DeCotis sits on the Investments, Audit and Nominating committees.

Betsy Gile, Director. Ms. Gile has served as our director since September 2017. Ms. Gile retired from Deutsche Bank AG in 2005, where she served as Managing Director and Global Head of the Loan Exposure Management Group. She spent the first 24 years of her career at J.P. Morgan, where she was responsible for High Grade Credit Markets trading, Credit Portfolio Management, Corporate Lending and Credit Research in North America. She is currently a member of the Board of Directors of KeyCorp, a bank holding company, Deutsche Bank Trust Company of the Americas, a subsidiary of Deutsche Bank AG, and of various funds managed by BlueMountain Capital, a diversified alternative asset manager. She is the head of the Risk Committee at both KeyCorp and Deutsche Bank Trust Company of the Americas. Ms. Gile holds a Bachelor of Arts in Government and History from Dartmouth College, where she graduated Phi Beta Kappa, Summa Cum Laude.

Watford believes that Ms. Gile's qualification to serve on our board of directors include her extensive investment industry experience particularly as it relates to investment risk management.

Ms. Gile sits on the Investment, Risk and Compensation committees.

Maamoun Rajeh, Director. Mr. Rajeh has served as our director since March 2018. Since October 2017, Mr. Rajeh has served as the Chairman and Executive Officer of Arch Worldwide Reinsurance Group. Prior to October 2017, Mr. Rajeh served as President and Chief Executive Officer of Arch Reinsurance Ltd since July 2014. Prior to July 2014, Mr. Rajeh served as President and Chief Executive Officer of Arch Reinsurance Europe Underwriting Limited since August 2012. Prior to August 2012, he served as Chief Underwriting Officer of Arch Reinsurance Ltd. since November 2005, which he had joined as an underwriter in 2001. Prior to joining Arch Reinsurance Ltd., Mr. Rajeh served as an Assistant Vice President at Hart Re, a subsidiary of The Hartford Financial Services Group, Inc. Mr. Rajeh graduated from The Wharton School of Business of the University of Pennsylvania with a B.S. degree. He is also a Chartered Property Casualty Underwriter.

We believe Mr. Rajeh's qualifications to serve on our board of directors include his many years of executive-level reinsurance industry leadership and his deep reinsurance industry underwriting experience.

Mr. Rajeh sits on the Underwriting, Strategy and Risk committees.

Robert Hawley, Chief Financial Officer. Mr. Hawley has served as Watford's Chief Financial Officer since July 2015. Mr. Hawley has over 20 years of professional experience in public accounting and reinsurance. Prior to joining Watford, he held the position of Vice President, Corporate Treasury Manager at XL Group Ltd. from January 2010 to July 2014. At XL Group Ltd., he was responsible for capital and collateral management, including debt capital market and credit facility transactions. From 2006 to 2009, Mr. Hawley worked at Renaissance Re Holdings Ltd., Bermuda, as the Assistant Treasurer where his role included treasury, rating agency and investor relations management. From 2002 to 2006, he worked as Assistant Vice President, Account Executive at Marsh & McLennan Companies Inc., Bermuda and was responsible for management of several Fortune 500 captive insurance companies. Prior to that, Mr. Hawley was a Corporate Advisory Services Manager at KPMG LLP, London, Canada, from 1995 to 2002. Mr. Hawley is a Chartered Professional Accountant, Chartered Accountant and a member of the Chartered Professional Accountants of Ontario, Canada. Mr. Hawley received an Advanced Business Accounting Diploma from Fanshawe College, Ontario, Canada.

Liz Cunningham, Chief Risk Officer. Ms. Cunningham has served as our Chief Risk Officer since January 2020. Ms. Cunningham has over 15 years of experience in the insurance and reinsurance industry, with a focus on risk management. From 2016 to 2019 she served as the Chief Risk Officer for Nautilus Indemnity Holdings Ltd. and its subsidiaries. Prior to joining Nautilus, Ms. Cunningham was a partner at Deloitte and led the Actuarial, Risk and Analytics practice across Bermuda and the Caribbean region. Ms. Cunningham provided actuarial, risk and consulting services to insurance and reinsurance clients writing property, casualty and specialty coverages across the globe. From 2006 to 2009, Ms. Cunningham worked as a Financial Risk Manager in the Insurance & Investments division of Scottish Widows, part of Lloyds Banking Group in the U.K. She started her career in 2003 as an actuarial consultant with PwC. Ms. Cunningham holds a Bachelor of Science (Honours) in Actuarial Mathematics and Statistics from Heriot Watt University and a MBA from Edinburgh Business School. She is a Fellow of the Institute and Faculty of Actuaries (U.K.) and a Chartered Enterprise Risk Actuary.

Laurence B. Richardson, II, Chief Operating Officer. Mr. Richardson has served as Watford's chief operating officer since January 2017. From March 2012 to January 2017, he held the position of Senior Vice President – Capital Markets at Arch Capital Group Ltd., where he primarily focused on convergence transactions through which reinsurance risk is transferred to capital markets investors. In such capacity, Mr. Richardson was involved in the formation and launch of Watford. Mr. Richardson was seconded to Watford by Arch Capital Group Ltd. from July 2016 to January 2017. Prior to joining Arch Capital Group Ltd., Mr. Richardson held the position of Senior Vice President in the Ventures Group at Renaissance Re, which develops and structures non-traditional reinsurance products, makes strategic investments and creates and manages Renaissance Re's joint ventures and other managed vehicles, including Top Layer Re, DaVinci Re, Timicuan Re, Starbound Re-I, Starbound Re-II and Channel Re. Mr. Richardson had joined Renaissance Re in mid-2001. Prior to joining Renaissance Re, Mr. Richardson was an investment banker with over 15 years of experience in the structured products and securitization arena, having been employed at a number of nationally recognized Wall Street firms, including the investment banks of E. F. Hutton & Co., Donaldson, Lufkin & Jenrette Securities Corporation, and Alex Brown & Sons, Incorporated and prior thereto was an attorney with the law firm Thacher, Proffitt & Wood LLP. Mr. Richardson graduated from the University of Virginia with both B.S. and J.D. degrees.

Alexandre Scherer, Chief Executive Officer of WSIC and WIC. Alexandre Scherer is the head of Watford's insurance operations and has served as the President and Chief Executive Officer of WSIC and WIC since September 2015 and August 2016, respectively. Mr. Scherer has over 23 years of experience in the insurance and reinsurance industry, including 11 years with AXA Insurance Company, a subsidiary of AXA S.A., of which he served eight years as President, Chief Executive Officer and director, as well as three years as Executive Vice President and Chief Operating Officer. Mr. Scherer also served as President and Chief Executive Officer, as well as Executive Vice President and Chief Operating Officer, of AXA Liabilities Managers, Inc., a subsidiary of AXA S.A. specializing in non-life insurance and reinsurance legacy business acquisition and management. Prior to that, he served as Vice President, Alternative Risk Transfer Underwriter, as well as Risk Manager, at AXA Reinsurance Company. Mr. Scherer also served as Second Vice President of Sorema North America and Underwriter and Head of Alternative Risk Transfer of Sorema SA. Mr. Scherer holds a degree of Diplome d'Ingenieur from École Centrale Paris in France. He is a Qualified Actuary from the French Actuaries Institute (France) and a Member of the American Academy of Actuaries.

Remuneration

When Watford established its remuneration programs, consideration was given to whether such programs align the interests of Watford's directors and officers with those of Watford's shareholders and whether such programs encourage unnecessary or excessive risk taking. Annual cash bonus awards focus on achievement of annual goals as well as both corporate performance measures and the executive officer's individual performance and are at the discretion of the Compensation Committee. Watford believes its compensation philosophy and programs encourage employees to strive to achieve both short- and long-term goals that are important to Watford's success and building shareholder value, without promoting unnecessary or excessive risk taking. Watford reviews its compensation policies and practices periodically to determine whether such policies and practices are appropriate in light of Watford's risk management objectives.

Directors

During the year ended 31 December 2020, the Group paid cash retainers to our independent directors for their service as members of the board of directors and any committees thereof. In addition, each independent director receives, as compensation for services as a director an annual grant of common shares pursuant to the 2018 Incentive Plan.

During the period up to his retirement as Chief Executive Officer, Watford did not pay any cash or equity compensation to Mr. Rathgeber as a director, as he was compensated as an employee of the Group. Watford also did not pay Mr. Papadopoulo or Mr. Rajeh any cash or equity compensation during the year ended 31 December 2020.

All directors were reimbursed for reasonable out-of-pocket expenses incurred for their service as members of the Board of Directors and any committees of the Board of Directors.

Executives

For the year ended 31 December 2020, Watford's executive officers were paid a base salary, an annual performance-based bonus which varies with the individuals' performance, and pension and other benefits. Such amounts are approved by the Compensation Committee.

Watford offers a retirement plan to all employees (including our named executive officers) for retirement savings. The plan qualifies under both the IRS regulations related to 401(k) plans for employees who are U.S. taxpayers and under the Bermuda pension regulations for non-U.S. employees. Under this plan, employees are allowed to defer and invest up to 100% of their cash earnings, subject to the maximum 401(k) contribution amount (which, in 2020, was $19,500 for those under 50 years of age and $26,000 for those 50 years of age or older). Contributions can be invested in a diversified selection of mutual funds. In order to encourage participation and to provide a retirement planning benefit to employees, we also provide a discretionary retirement contribution to each employee's retirement account as a form of matching, and a profit-sharing contribution of 4% of an employees' eligible compensation, provided that profit share contributions are limited to the lesser of 4% of an employee's compensation or, in 2020, $9,000. All new employee contributions are fully vested immediately upon entry to the plan.

Material transactions with shareholder controllers

Arch Reinsurance Ltd. ("ARL") is party to certain quota share agreements with one or more of Watford's operating subsidiaries and also owns approximately 12.6% of the outstanding common shares of WHL as of 31 December 2020.

In addition, WHL has a long-term services agreement with Arch Investment Management Ltd ("AIM") to manage a portion of our investment grade portfolio.

Risk Management and Solvency Self-Assessment

The following narrative provides an overview of the Group's Risk Management Framework ("Framework"), which describes the Group's methodology for identifying, measuring, and reporting on the key risks affecting Watford. It outlines our approach to risk identification and assessment, and how risk management is implemented and integrated into the organizational structure of the business.

Description of Risk Management Process

Watford has developed its Framework and Risk Register to identify and assess the material risks faced by the Group. Watford has produced an enterprise-wide risk assessment which details all of the significant risks facing the Group. This risk assessment was performed at the highest levels of the Group and involved input from the Board and senior management.

Watford's Framework and Risk Register lists the risks faced by Watford, as well as current and planned controls being implemented. The Framework documents Watford's Corporate Governance, Risk Management, and material risks.

The Risk Register has been developed to identify and assess the material risks faced by Watford in more granular detail than the Framework. This register contains the following:

- The Board Committee ultimately responsible for the risk
- The Risk Owner for each Risk
- A list of monitoring procedures for each risk, if applicable
- A list of mitigation procedures for each risk, if applicable
- A list of risk control procedures for each risk, if applicable

The rating of each risk is derived from an assessment of likelihood and impact. This assessment is made at both an inherent level and after consideration of Watford's control environment, including mitigation techniques and controls in place at service providers.

The Risk Register is a key input into the risk management regime, and any material changes in the underlying risks will be modelled for potential impact upon Watford's capital requirements. Such changes include, but are not limited to, changes in business mix, strategy and investment policy and investment performance. The rating of risks is considered by management on at least an annual basis and the rating for the most significant risks is reviewed by the Group's Risk Committee and presented to the Board of Directors.

The controls identified in the Risk Register to monitor, mitigate and control the risks facing Watford are reviewed for continued relevance and documented in the process documents for each function. Compliance with the components of these controls is verified via the ongoing management reviews and Internal Audit reviews undertaken at Watford. This is undertaken on a group-wide basis and any issues are reported to the Watford board.

The Board of Directors have reviewed and formally approved the Risk Register, as well as provided input in the scoring of the risks faced by Watford. Working with the Board, Watford has established Risk Appetites for each material risk. Watford has put into place procedures for risk measurement, mitigation, and controls, as well as monitoring compliance with the Board's set Risk Appetite.

Watford's Risk Management Function is led by its Chief Risk Officer ("CRO") who is a member of the Executive Management team. The CRO performs regular risk reporting to the Board each quarter.

Implementation and Integration of Solvency Self-Assessment

Watford has built business processes that provide a forward looking analysis of our risks and capital management. Watford analyzes its exposure to adverse underwriting and investment scenarios on a regular basis. These tests help Watford quantify the magnitude of capital required under stressed scenarios.

Watford's Solvency Self-Assessment process includes:

- A quarterly estimate of single name concentrations within the underwriting portfolio, a quarterly estimate of the PMLs, quarterly estimates of Underwriting Stress scenarios, as well as annual estimates of various Lloyd's Realistic Disaster Scenarios ("RDS").
- Stress tests of it its investment portfolio under historical and hypothetical periods of investment market turmoil, and the effects on Watford's liquidity position.
- An annual planning analysis of our underwriting and investment activities, with quarterly monitoring and reforecasts presented to the Board. Watford has utilized the internal models calibrated to rating agency and regulatory requirements as part of our assessment of the capital requirements of our proposed business plans, and measures its projected forward looking capital adequacy and liquidity position in historical and hypothetical stressed scenarios.

Watford's annual business plan is prepared by the Group's senior management and is approved by the Board of Directors after review of the results of these solvency assessments. The approval of the 2021 – 2023 business plan has been deferred given the proposed Merger transaction however Management continue to undertake quarterly monitoring against the plan previously approved for financial year 2021.

Currently, the amount of capital required to cover our material risks is assessed through regulatory capital requirements, rating agency models, internally developed stress tests, internally developed default and recovery analysis for our credit investments, internally developed liquidity models and stress tests, and underwriting realistic disaster scenarios.

The risk management framework is designed to help Watford set a coherent risk management strategy and to enhance the likelihood of meeting its strategy. This framework has therefore been designed with the following objectives:

- Identify all significant risks assumed by Watford through its business, internal processes and relevant external environment.
- Measure identified risks on a consistent basis.
- Establish a set of responses to manage risks within the stated risk appetite and tolerances.
- Establish the principles by which Watford can evaluate the risk/reward trade-offs associated with key strategic and tactical decisions.
- Ensure return on capital goals are met through the efficient use and allocation of capital.
- Provide a regular assessment of Watford's solvency and liquidity through the use of quantitative metrics, including stress and scenario testing.

Internal Controls

Watford maintains an effective internal control system, which includes administrative and accounting procedures, an internal control framework, appropriate reporting arrangements and a compliance function.

The Board is responsible for monitoring the establishment and maintenance of the system of controls used to assess and manage exposure to all areas of risk. The objectives of these controls are to ensure that Watford's risk strategy is maintained and risk remains within the appetite and tolerances approved by the Board.

As part of Watford's business model, many of the day-to-day operations are outsourced to third party service providers and the internal control environment has been structured to appropriately address the risks related to this business model. For more detail on the services outsourced, refer to the Outsourcing section below. All relevant controls in place at Watford's outsourced service providers have been included in Watford's Risk and Control Matrices to provide management oversight of all activities. Watford places reliance on controls that exist at the relevant third party providers and as such relies heavily on the internal audit function described below to review controls performed at these entities and perform on-site visits as required.

Watford's Compliance Function is led by our Chief Operating Officer. The function has established a compliance program to ensure compliance with all relevant laws, legislation, regulations and guidance. Watford's Compliance Function assists the Board in achieving its overall strategic objectives by promoting a culture of integrity, ethical conduct and compliance with the laws, regulations and administrative provisions that affect Watford. The compliance function also is responsible for the ongoing assessment of any possible impact of changes in the legal environment on our operations and for the identification and assessment of Legal / Litigation risk and for monitoring adherence to certain elements of the risk management framework and reporting thereon to the appropriate forums.

The Board has approved the establishment of a compliance and ethics program to ensure that all companies within the group promote an organizational culture that encourages the highest standards of ethical business conduct and compliance with the Group's Code of Business Conduct, policy statements and any laws and regulations which govern the Group's business activities (collectively referred to as the "Compliance Program"). The Compliance Program is intended to ensure that all companies within the Group exercise appropriate due diligence to prevent conduct which is in violation of its Compliance Program, thereby protecting the Group's reputation and good name.

The requirements of the Compliance Program apply to all employees, officers and directors of the Group and, where appropriate, to agents of the Group.

Internal Audit

The Group has outsourced its Internal Audit function to a third party who, along with their internal processes to ensure independence from the Group, has direct access to the Audit Committee, agree the audit plan with the Audit Committee, and provide findings reports from each audit for discussion at the Audit Committee. Internal Audit's primary objective is to work with management to identify and address risks relating to processes integral to the achievement of business objectives. The function serves as an independent and objective source of appraisal and assurance within Watford to support management, the Audit Committee and the Board of Directors in discharging their responsibilities. The Internal Audit function has direct and frequent communication with the Audit Committee where any issues identified are raised.

Internal Audit also assists management, the Audit Committee and the Board of Directors in evaluating the appropriateness and effectiveness of business processes, internal controls and the governance and risk management functions. Internal Audit also identifies process improvements, including those resulting from a changing operating environment and will make recommendations to management.

Internal Audit performs special examinations at the request of management, the Board and the Audit Committee.

Internal Audit performs a risk assessment on an annual basis to ensure that its work is focused on the key risks and how effectively management mitigates or manages these risks. Internal Audit evaluates all significant functions and bases its Annual Plan on a risk-based approach. As such, Internal Audit has sufficient knowledge and experience to provide insight into the effectiveness of the risk management system and is a key input into the system of internal control.

The Board of Directors has final responsibility, with delegation to the Audit Committee in the areas noted above. In respect of compliance with stated risk tolerances, the risk management function has responsibility for the identification and reporting of non-compliance, with much of the detailed work to review the effectiveness of risk controls delegated to the internal audit function, as well as through the reporting by the compliance function at key service providers.

Identification of risks as they relate to compliance with jurisdictional laws, regulations, policies and procedures, together with the appropriateness of the response to any risks identified, is a responsibility of the Chief Operating Officer.

Actuarial Function

The Watford Actuarial function is responsible for:

- Performing loss liability estimates, including assessing the quality of underlying data
- Assisting in the execution of the risk management framework.
- Performing actuarial pricing analyses on assumed underwriting risks
- Provide support of financial information to the regulatory authorities

The day to day activities of the Actuarial Function is split between Watford and Arch as outlined in the Services Agreements. As part of the underwriting process, Arch actuaries are involved in the pricing of individual contracts. Procedures and controls surrounding these pricing mechanisms at Arch are reviewed by Watford CEO.

Also as part of the Service Agreements, Arch actuaries provide loss and LAE liability reserve recommendations on a contract by contract basis. These reserve recommendations are derived from the same policies and procedures that Arch utilizes for its own portfolio. Watford Management (CEO, CRO and CFO) discuss and review the reserve recommendations with the Arch actuaries and underwriters.

Further, Watford has employed an external third party actuarial firm to provide an independent loss reserve review on a quarterly basis and serve as the appointed loss reserve specialist for annual regulatory filings in Bermuda and the United States. The loss reserve specialist is responsible for providing a professional opinion on the reasonableness (or adequacy[1]) of the carried reserves.

Ultimate responsibility and oversight of the Actuarial Function is assumed by Watford management. Both the CEO and CRO are qualified actuaries.

The Actuarial Function is comprised of experienced individuals with in-depth knowledge of, and professional qualifications, in actuarial and financial mathematics. The Actuarial Function is structured appropriately given the nature, scale and complexity of the risks inherent in the Group's operations. This allows Watford to have a robust process for setting loss reserves, leveraging the established processes and procedures employed by Arch, making our own analyses and judgments, and through periodic reviews by external actuarial firms.

[1] The exact structure of the opinion as defined by local regulations.

Outsourcing

Watford maintains a lean management team, and works closely with outsourced serviced providers to achieve our strategic goals. We outsource significant elements of our business to third party service providers. Key outsourced services include the following:

- Investment management services
- Investment accounting services
- Underwriting management services
- Internal Audit
- Loss Reserve Specialist (as discussed above)

For our underwriting operations, Arch provides underwriting services including sourcing and evaluating underwriting opportunities, claims-handling, loss control, exposure management, portfolio management and modeling, as well as statistical, actuarial, and administrative support services, in each case, subject to Watford's underwriting and operational guidelines and the oversight of Watford's senior management and Board of Directors.

In regard to our investments, HPS manages Watford's non-investment grade portfolio and a portion of our investment grade assets. AIM manages the majority of our investment grade portfolio with other investment managers also retained to manage some of our investment grade exposure, all are subject to Watford's investment guidelines and the oversight of the senior management and Board of Directors.

Watford outsources these functions in order to cost-effectively leverage the expertise and strong market positions of these trusted partners. Through Watford's association with Arch, we benefit from Arch's worldwide platform on a variable cost basis, thus avoiding the fixed expense of maintaining a multi-line platform for our underwriting operations. Similarly, we believe that the structure of the compensation we pay to HPS and AIM provides benefits to us both in terms of cost-effective access to the expertise required to execute our investment strategy and in aligning interests. Investment accounting services are performed by BlackRock.

Management ensures that any outsourced responsibilities are delegated and managed appropriately, with ultimate responsibility resting with the Watford Board.

Watford Internal Audit performs reviews of these controls on an ad-hoc basis to confirm that outsourced providers are acting as expected.

Any other material information

John Rathgeber retired as Chief Executive Officer on March 31, 2020, remaining as a director of the Company. Mr. Rathgeber served as a senior advisor to the Company from April 1, 2020 to June 30, 2020, and subsequently resigned as a member of Watford's board of directors on October 28, 2020.

There is no other material information in regards to the Group's governance structure that has not been included above.

SECTION C – RISK PROFILE

Overview

Watford's risk appetite framework provides an expression of the level of risk the Group is willing to accept in pursuit of its strategic objectives. The risk appetite framework provides quantitative and qualitative statements which are used to define the general attitude within the organization towards the desired level of risk. It not only supports the Group's risk management framework, it also enables us to make informed business decisions having regard to the key risks to which it may be exposed by such a decision.

Underwriting Risk

Underwriting risk comprises Pricing Risk, Reserve Risk and Catastrophe Risk and manifests itself as the risk of loss, or adverse change in the value of insurance liabilities, due to inadequate pricing and/or loss-provisioning assumptions.

Pricing risk is defined as the risk that premiums plus any investment income earned thereon are not sufficient to cover losses when they come due in the future. If a contract is incorrectly priced at inception, then the total amount of revenue Watford ultimately collects related to that contract may not be sufficient to cover emerging claims.

Reserving risk is defined as the risk that loss reserves set aside by Watford in respect of insurance claims (whether actual reported or potential future claims) will not be sufficient to fully cover the ultimate claim amounts, and includes the risk of loss from the uncertainty around the timing of the claims payments.

Catastrophic risk is the risk of loss from infrequent, high-severity claims from natural or man-made disasters.

Watford understands the importance of proper pricing controls, risk selection, exposure monitoring and claims management in order reduce the underwriting risk to an acceptable level.

The Underwriting Committee and the Board retain overall responsibility to maintain adequate, sound and appropriate risk management processes and internal control mechanisms for the purpose of assessing and managing exposure to Underwriting Risk. The Board has delegated oversight of underwriting risk controls and day-to-day management of these risk controls to Arch. The Chief Risk Officer has been assigned the responsibility of monitoring Underwriting Risk.

The Group measures, manages, and reports on its Underwriting Risk in the following ways:

- Arch employs its established underwriting, pricing, and risk management procedures for the Watford portfolio on the same basis as it does for its own portfolio
- Watford and Arch have agreed a set of guidelines ("Underwriting Guidelines") pursuant to which Underwriting Risk is to be managed. The Underwriting Guidelines are monitored and reviewed to ensure compliance with Watford's objectives and risk tolerances set out therein

- As part of the Services Agreement between Arch and Watford, there is regular reporting of individual bound contracts, Probable Maximum Losses for Property Catastrophe Exposures, Realistic Disaster Scenarios, and other data points.
- The Group conducts quarterly loss liability reviews reflecting the input from the Arch reserving process, our 3rd party actuarial firm, as well as our own analyses
- The Group measures and monitors the underwriting results utilizing its own procedures including risk aggregation, Watford specific underwriting stressed scenarios, and actual performance relative to expectations

Watford Internal Audit conducts periodic reviews and tests the controls in place at Arch and Watford in order to confirm their operational effectiveness. Watford management also maintains detailed Risk and Control Matrices to identify the population of controls in place at Arch and Watford.

Investment Risk

Investment risk manifests itself as the risk of investment returns being lower than Watford's investment return targets, either through reduced market valuations of the investment assets or reduced income/yield from our investments, or a combination of the two factors, which is known as "total return". Ultimately, a failure of the total return from our investment portfolio might result in the inability to pay claims to policyholders. An assumed level of investment total return is a meaningful component in the original pricing of each contract and also in the estimation of the level of loss reserves necessary to cover expected future losses, and a shortfall in investment return (versus expectations) would have an adverse effect on Watford's results and potentially its ability to meet its obligations when they become due.

In addition, the risk of default (credit risk) of individual investments is an investment risk to which Watford is subject. Credit risk can arise from borrowers suffering business or financial stress, from increased debt service costs due to rising interest rates and many other factors.

In addition, the risk of default (credit risk) of investments is treated as an investment risk given the impact that widening credit spreads, obligor defaults and company failure can have on the investment portfolio. The risk of default of Watford's reinsurers is considered in a further section of this framework. Watford considers the implication of investment credit risk when evaluating concentration risk.

The Investment Committee and the Board retain overall responsibility to maintain adequate, sound and appropriate risk management processes and internal control mechanisms for the purpose of assessing and managing exposure to Investment Risk. The Board has delegated oversight of investment risk controls and day-to-day management of these risk controls to the relevant investment managers per investment management agreements. The Chief Risk Officer has been assigned the responsibility of monitoring Investment Risk.

The Group measures, manages, and reports on its Investment Risk in the following ways:

- Watford and its Investment Managers have agreed a set of guidelines ("Investment Guidelines") pursuant to which Investment Risk is to be managed. The Investment

Guidelines are regularly monitored and reviewed seeking to ensure compliance with Watford's investment objectives and risk tolerances set out therein.

- Watford's Investment Manager's employ their own established risk management procedures on the behalf of the Watford portfolio
- There is regular reporting to Watford by its Investment Managers on the performance, material positions and risk profile of the portfolios
- The Group regularly measures and monitors its Investment Risk across the enterprise including stress testing its market, credit, and liquidity risk as it relates to its investments

Watford Internal Audit reviews and tests the controls in place at HPS and Watford in order to confirm their operational effectiveness. Watford management also maintains detailed Risk and Control Matrices to identify the population of controls in place at HPS and Watford.

Liquidity Risk

Liquidity Risk is the risk that Watford is unable to liquidate/sell investments at or near market value in a timely fashion in order to settle financial obligations as they come due. Watford views its liquidity risk across four dimensions:

- Funding Liquidity Risk – the risk that Watford will be unable to meet cash, asset, margin, and collateral requirements of counterparties

- Asset Liquidity Risk – the risk that Watford will not be able to execute a transaction at the prevailing market price because there is temporarily no demand for the deal

- Market Risk – the risk that changes in financial market prices and rates will reduce the value of an asset or liability

- Reserve Risk – Reserving risk is defined as the risk that reserves set in financial statements in respect of insurance claims are not sufficient to fully cover the claim amounts, and includes the risk of loss from the uncertainty around the timing of the claims payments

The Risk Committee and the Board retain overall responsibility to maintain adequate, sound and appropriate risk management processes and internal control mechanisms for the purpose of assessing and managing exposure to Liquidity Risk. The Board has delegated oversight of the risk controls and day-to-day management of these risk controls to the investment managers. The Chief Risk Officer has been assigned the responsibility of monitoring Liquidity Risk.

As part of its risk management program, Watford assesses its liquidity position as it relates to assets, liabilities, and collateral on a quarterly basis.

Credit Risk

Watford considers credit risk in terms of the risk of default of insureds/reinsurers and reinsurance intermediaries. Credit risk of the investment portfolio is considered as an Investment, Liquidity, and Market Risk. As such Credit Risk relates to the risk of loss, or adverse change in financial condition, resulting from fluctuations in the credit standing of insureds and reinsurers.

Any change in the credit standing of Watford's insureds and reinsurers potentially affects the value of premiums receivable and reinsurance recoverable.

The Risk Committee and the Board retain overall responsibility to maintain adequate, sound and appropriate risk management processes and internal control mechanisms for the purpose of assessing and managing exposure to Credit Risk. The Board has delegated oversight of the risk controls and day-to-day management of these risk controls to Arch. The Chief Risk Officer has been assigned the responsibility of monitoring Credit Risk.

As part of the service agreement between Arch and Watford, Arch provides administrative services for the direct business, retroceded business from Arch entities, and any outward reinsurance purchased by Watford. A key monitoring procedure performed by Arch with respect to credit risk is an aged receivable report, which measures and tracks the magnitude and age of outstanding balances due to Watford by its cedants. In addition, Watford monitors its own outward reinsurance recoverable on a quarterly basis as part of its Risk Management Report.

At 31 December 2020 the majority of reinsurance recoverables for paid and unpaid losses were due from entities with a rating of A- or better from A.M. Best Company.

Operational Risk

Operational risk presents itself as the risk of a loss from inadequate or failed internal processes, or from personnel and systems, or from external events. Watford also includes in Operational Risk the risk of loss resulting from failure to comply with laws as well as prudent ethical standards and contractual obligations. It also includes the exposure to litigation from all aspects of business activities.

The Risk Committee and the Board retain overall responsibility to maintain adequate, sound and appropriate risk management processes and internal control mechanisms for the purpose of assessing and managing exposure to Operational Risk. The Chief Risk Officer has been assigned the responsibility of monitoring Operational Risk.

Key business and systems processes are documented by Watford to confirm understanding. These processes include procedures around Human Resources, Business Processes, Information Systems, Fraud, and Insurance Distribution.

Reputational Risk

We view Reputational Risk across four dimensions:

- Internal Reputational Risk – the Group suffers adverse impact due to negative publicity or perception of the Group due to its own acts
- Service Provider Reputational Risk – the Group suffers adverse impact due to negative publicity, perception, of its material business partners
- Rating Agency Risk – the Group fails to understand the rating methodologies, does not execute its business plan, or otherwise fails to mitigate a risk in another area resulting in a negative watch or downgrade

- Regulatory Risk – the Group fails to understand and comply with the legislative requirements or otherwise fails to mitigate a risk in another area resulting in a loss of its insurance license.

In attempting to manage reputational risk, the Risk Management Framework has been established to ensure that adverse impacts on Watford's reputation or credibility are appropriately monitored, controlled and mitigated.

Through our Risk Management process, we seek to avoid harming our brand and market credibility, our rating agency relationships, and our regulatory relationships.

The CEO and the Board are responsible for managing the firm's reputational risk. The Audit Committee and the Board retain overall responsibility to maintain adequate, sound and appropriate risk management processes and internal control mechanisms for the purpose of assessing and managing exposure to Reputational Risk.

Watford has regularly scheduled calls with rating agencies, regularly scheduled meetings with its Regulatory Authorities, and regularly scheduled meetings with its material service providers.

Risk Mitigation in the Organization

Watford has developed a number of mitigation actions as discussed under each risk identified above. Mitigation strategies include the oversight of strategic partners in Watford's outsourced business model and rigorous review of the compliance with agreed guidelines. Watford's internal audit function will also review controls and escalate issues to the Audit Committee as required.

Material Risk Concentrations

Under Watford's internal underwriting policy, it is required that management ensures there is not excessive exposure to risk concentrations. In conjunction with the contract reviews, the CRO collates and maintains data sufficient to assess the common risk drivers and monitor concentrations of risk. The Risk Management Report also contains a summary of the portfolio against the concentration limits and recommendations for any actions to be taken. Concentration limits in respect of the underwriting portfolio include limiting Watford's occurrence Probable Maximum Loss ("PML") from a property catastrophe by region and other single man-made disaster scenarios to a maximum of 10% of capital.

It is also possible for material risk concentrations to arise in investment portfolios without proper mitigation and oversight. In order to reduce these Watford limits single-name investment aggregations to a maximum of 7.5% of Long Market Value of the HPS non-investment grade portfolio as a whole.

Watford's portfolios are within these aforementioned concentration limits. Other underwriting stress and scenario test results are assessed and tracked quarterly in order to identify potential risk exposures by line of business. For lines of business where these tests are close to or exceed the 10% threshold, more detailed review and/or monitoring is undertaken. These metrics are separate from (but supplement) the concentration limits noted previously.

Investment in Assets in Accordance With the Prudent Person Principles of the Code of Conduct

Watford's portfolios are invested pursuant to investment guidelines formulated to complement the underwriting portfolio. We pursue a diversified insurance portfolio with a focus on medium and long tail casualty lines of business. The investment guidelines are monitored and reviewed continuously to ensure compliance with the investment objectives and risk tolerances outlined therein.

In all cases, Watford invest assets in accordance with the Prudent Person Principle. That is, the Board must discharge its duties with the care, skill, prudence and diligence that a prudent person acting in a similar capacity would use in the conduct of an enterprise of similar character and objectives.

Stress Testing

Watford analyzes its exposure to adverse underwriting and investment scenarios on a regular basis. These tests help Watford quantify the magnitude of capital required under stressed scenarios. Our Risk Management processes include a quarterly estimate of single name concentrations within the underwriting portfolio, a quarterly estimate of the PMLs, and a quarterly estimate of Watford specific underwriting stressed scenarios. For investments, stress tests are performed on the results of the capital models on the pro-forma Group utilizing our budgeting analysis to ensure that risk in the investment portfolio is within internal tolerances. These stress tests focus on mark-to-market volatility in the investment portfolio. Additionally, we stress test our investment portfolio by estimating the valuation under both historical and hypothetical periods of investment market turmoil. These stress tests are presented to the Board on a quarterly basis. The results of our capital planning and stress scenario tests are important components of our management process.

Based upon these stress tests, the Group believes that it has sufficient capital and liquidity to comply with the contractual obligations of the organization and regulatory requirements upon experiencing losses within its risk tolerances.

Further, it should be noted that the normal course of our stress testing contemplated market turmoil as extreme as that experienced during Q1 2020 during the COVID-19 market disruption. Watford's actual experience and its results at Q1 2020 were within the modelled expectations.

Any other material information

There is no other material information in regards to the Group's risk profile that has not be included above.

SECTION D – SOLVENCY VALUATION

Valuation Bases, Assumptions and Methods to Derive the Value of Each Asset Class

The Group has used the valuation principles outlined by Bermuda Monetary Authority's "Guidance Note for Statutory Reporting Regime" for the reporting period's statutory filing. 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 Group uses its investment managers and/or pricing services to prepare inputs to assist the Group with mark to model valuations.

Equities and investment funds - includes common stock and preferred shares 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.

Valuation Bases, Assumptions and Methods to Derive the Value of Technical Provisions

Insurance technical provisions are valued based on best estimate cash flows, adjusted to reflect the time value of money using a risk-free discount rate term structure with an appropriate illiquidity adjustment. In addition, there is a risk margin to reflect the uncertainty contained inherent in the underlying cash flows which 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 Bermuda Monetary Authority for each reporting period.

The best estimate for the loss and loss expense provision is calculated by using United States Generally Accepted Accounting Principles (US GAAP) reserves as the starting point and then performing a series of adjustments:

- Removal of prudence margins
- Incorporation of expected reinsurance counterparty defaults
- Incorporation of events not in data (ENID)
- Other adjustments related to consideration for investment expenses.
- Discounting of cash flows

The best estimate for the premium provision is calculated by using the unearned premium reserve on a US GAAP basis, adjusting for bound but not incepted business as at 31 December 2020 and applying expected future loss ratios, expense ratios and appropriate claims pay-out patterns to derive cash flows which are then discounted.

At 31 December 2020, the total Net Technical Provisions amounted to $1,355,568,000 comprising of the following (on an EBS basis):

	2020	2019
Net premium provisions	$ (25,217,000)	(93,150,000)
Net loss and loss expense provisions	1,243,744,000	1,062,341,000
Risk margin	137,041,000	120,793,000
Total general business insurance technical provisions	$ 1,355,568,000	1,089,984,000

Description of Recoverable 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. The balance is adjusted for counterparty credit rating based on rating agency and experience default statistics. Through reinsurance agreements with Arch and other 3rd party reinsurers, Watford cedes a portion of its premiums. At 31 December 2020 the majority of reinsurance recoverables for paid and unpaid losses were due from counterparties with a rating of A- or better from A.M. Best Company.

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

Similar to the valuation principles for assets, the Group's liabilities follow the valuations principles outlined by Bermuda Monetary Authority's "Guidance Note for Statutory Reporting Regime" which values liabilities at a fair value basis. All other liabilities are valued on a US GAAP basis and settlements not expected to be settled within a year are discounted using the prescribed discount rates provided by the Bermuda Monetary Authority as at 31 December 2020.

Any other material information

There is no other material information in regards to the Group's solvency valuation that has not be included above.

SECTION E – CAPITAL MANAGEMENT

Capital Management Policy

The primary capital management objectives of the Group are to maintain a strong capital base to support the development of its business and to meet regulatory and rating agency capital requirements at all times. The Group strives to be efficient and prudent user of capital, maintaining target capital levels at or above those required for an "A-" rating from A.M. Best, and above requirements of our insurance regulators.

In addition to the common shares, contingently-redeemable preference shares and senior notes we issued, we have arranged credit facilities to support our business operations. We believe that we hold sufficient capital to allow us to take advantage of market opportunities and to maintain our financial strength ratings, as well as to comply with all applicable statutory regulations.

We monitor our capital adequacy on a regular basis and will seek to adjust our capital base (up or down) according to the needs of our business. As part of our capital management program, we may seek to raise additional capital or may seek to return capital to our shareholders through share repurchases, cash dividends or other methods (or a combination of such methods). Any such determination will be at the discretion of our board of directors and will be dependent upon our profits, financial requirements and other factors, including legal restrictions, rating agency requirements and such other factors as our board of directors deems relevant.

There have been no material changes to capital during the reporting period.

At December 31, 2020 the Group's Eligible Capital was categorized as follows:

Tier	Eligible Capital	Applied to Minimum Margin of Solvency	Applied to Enhanced Capital Requirement
Tier 1	847,189,000	847,189,000	847,189,000
Tier 2	56,340,000	56,340,000	56,340,000
Tier 3	172,689,000		159,4730,000
Total	**1,076,219,000**	**903,529,000**	**1,063,002,000**

At December 31, 2020 the eligible capital for WRL was categorized as follows:

Tier	Eligible Capital	Applied to Minimum Margin of Solvency	Applied to Enhanced Capital Requirement
Tier 1	1,089,565,000	1,089,565,000	1,089,565,000
Tier 2	10,673,000	10,673,000	10,673,000
Tier 3			
Total	**1,100,238,000**	**1,100,238,000**	**1,100,238,000**

Tier 1 capital consists of capital stock, contributed surplus and statutory surplus.

Tier 2 capital consists mainly of the excess of encumbered assets vs. liabilities for WRL. For the Group, Tier 2 capital includes Watford's preference shares.

Tier 3 is the Senior Notes issued in July 2019.

Confirmation of Eligible Capital That is Subject to Transitional Arrangements

Not applicable

Identification of Any Factors Affecting Encumbrances on Capital

Watford utilizes letters of credit and trust accounts to meet collateral requirements and therefore is required to maintain assets on deposit to support its insurance and reinsurance obligations. Additionally, Watford maintains assets on deposit with various regulatory authorities to support our insurance business.

Identification of Ancillary Capital Instruments Approved by the Authority

Not applicable

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

The following is a reconciliation of US GAAP shareholders' equity to statutory capital and surplus as of December 31, 2020.

At December 31, 2020 the reconciliation of the WRL equity:

	December 31, 2020
Total US GAAP Shareholders' Equity	1,190,378,000
Non-admitted assets	(6,208,000)
Statutory Capital and Surplus	1,184,170,000

At December 31, 2020 the reconciliation of the Group equity:

	December 31, 2020
Total US GAAP Shareholders' Equity	993,742,000
Non-admitted assets	(6,279,000)
Senior Notes	172,689,000
Statutory Capital and Surplus	1,160,152,000

ECR and MSM Requirements at the End of the Reporting Period

At December 31, 2020 the Group's regulatory capital requirements were assessed as follows:

Minimum Margin of Solvency: $267,585,000
Transition Enhanced Capital Requirement: $691,868,000
Enhanced Capital Requirement: $739,611,000

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

At December 31, 2020 the WRL regulatory capital requirements were assessed as follows:

Minimum Margin of Solvency: $253,600,000
Transition Enhanced Capital Requirement: $691,238,000
Enhanced Capital Requirement: $740,025,000

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

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

Not applicable.

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

Not applicable.

Approved Internal Capital Model

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

Any other material information

In the first quarter of 2020, the board of directors of the Parent authorized the Company's investment in its common shares through a share repurchase program under which the Company may repurchase up to $50 million of its outstanding common shares (the "current share repurchase program"). During the first quarter of 2020, the Company purchased 127,744 shares at an average price per share of $22.42 under the current share repurchase program.

As of March 31, 2021, approximately $47.1 million of unused share repurchase capacity remained available under the current share repurchase program. Since the inception of the share repurchase programs through March 31, 2021, the Company has repurchased a total of 2.9 million shares. At March 31, 2021, the shares are held in treasury, at an aggregate cost of $77.9 million (excluding transaction costs).

Repurchases of the Company's common shares and other share-based transactions are recorded at cost and result in a reduction of the Company's shareholders' equity in its consolidated balance sheets. The Company does not anticipate making any further repurchases under its current share repurchase program as a result of its pending acquisition by HoldCo.

There is no other material information in regards to the Group's capital management that has not be included above.

SECTION F – SUBSEQUENT EVENTS

On April 9, 2021, the Company completed its acquisition of 100% of the capital stock of Axeria IARD, a property and casualty insurance company based in France, from the APRIL Group. The total consideration paid was €45.1 million.

DECLARATION

To the best of our knowledge and belief, the Financial Condition Report represents the financial condition of Watford Re Ltd. and the Watford Group in all material respects

Jon Levy

Chief Executive Officer

Liz Cunningham

Chief Risk Officer

APPENDIX 1 – CORPORATE STRUCTURE