

# Associated Electric & Gas Insurance Services Limited

Consolidated Financial Statements as of  
December 31, 2019 and 2018 and for the  
Years Ended December 31, 2019, 2018 and 2017 and  
Independent Auditors' Report

# Associated Electric & Gas Insurance Services Limited

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## **INDEPENDENT AUDITORS' REPORT**

To the Members of  
Associated Electric & Gas Insurance Services Limited:

We have audited the accompanying consolidated financial statements of Associated Electric & Gas Insurance Services Limited ("AEGIS" or the "Company"), which comprise the consolidated balance sheets as of December 31, 2019 and 2018, and the related consolidated statements of income and comprehensive income, changes in surplus, and cash flows for each of the three years in the period ended December 31, 2019, and the related notes to the consolidated financial statements.

### **Management's Responsibility for the Consolidated Financial Statements**

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### **Auditors' Responsibility**

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Company's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

### **Opinion**

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Associated Electric & Gas Insurance Services Limited as of December 31, 2019 and 2018, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2019 in accordance with accounting principles generally accepted in the United States of America.

### **Required Supplementary Information**

Accounting principles generally accepted in the United States of America require that the information about incurred and paid claims development prior to 2019 within Note 8 to the financial statements be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Financial Accounting Standards Board, which considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other

knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

*Deloitte & Touche LLP*

April 2, 2020

# Associated Electric & Gas Insurance Services Limited

## Consolidated Balance Sheets As of December 31, 2019 and 2018 (Expressed in thousands of U.S. dollars)

	2019	2018
<b>Assets</b>		
Cash and cash equivalents <sup>(1)</sup>	\$ 389,474	\$ 265,702
Investments (held at fair value: 2019 - \$2,871,958; 2018 - \$ 2,707,338) <sup>(1)</sup>	4,116,213	3,997,286
Mortgage loans, net of valuation allowances	<u>198,482</u>	<u>172,576</u>
Total cash and investments	4,704,169	4,435,564
Due from reinsurers	1,943,206	1,593,885
Due from insureds	11,601	91
Accrued interest <sup>(1)</sup>	25,085	22,103
Premiums receivable	324,006	256,901
Receivable for securities sold	28,835	1,561
Current income taxes receivable <sup>(1)</sup>	23,395	32,578
Unearned continuity and other premium credits	31,470	29,423
Prepaid reinsurance premiums <sup>(1)</sup>	347,829	278,080
Net deferred tax asset <sup>(1)</sup>	46,987	75,442
Deferred acquisition costs	95,914	87,065
Deposit assets	123,980	123,265
Other assets	<u>161,687</u>	<u>137,716</u>
Total Assets	<u>\$ 7,868,164</u>	<u>\$ 7,073,674</u>
<b>Liabilities and Surplus</b>		
Liabilities:		
Reserve for losses and loss expenses	\$ 4,028,487	\$ 3,659,832
Unearned premiums	1,021,447	868,044
Fair value of insurance and reinsurance contracts	532,628	472,057
Due to reinsurers <sup>(1)</sup>	218,699	159,037
Payable for securities purchased	13,824	14,368
Deposit liabilities	123,980	123,265
Accrued expenses and other liabilities <sup>(1)</sup>	<u>146,546</u>	<u>140,943</u>
Total liabilities	6,085,611	5,437,546
Commitments and Contingencies		
Surplus:		
Statutory surplus fund	250	250
Policyholders' surplus	1,743,723	1,606,780
Accumulated other comprehensive income	<u>38,580</u>	<u>29,098</u>
Total surplus	1,782,553	1,636,128
Total Liabilities and Surplus	<u>\$ 7,868,164</u>	<u>\$ 7,073,674</u>

<sup>(1)</sup> See Note 6 for details of balances associated with variable interest entities.

See notes to the consolidated financial statements.

# Associated Electric & Gas Insurance Services Limited

## Consolidated Statements of Income and Comprehensive Income For Years Ended December 31, 2019, 2018 and 2017 (Expressed in thousands of U.S. dollars)

	2019	2018	2017
Revenue:			
Gross premiums written	\$1,815,733	\$1,567,145	\$1,344,705
Net premiums written	<u>1,156,788</u>	<u>1,028,021</u>	<u>880,647</u>
Net premiums earned	1,071,783	961,028	852,131
Net investment income	218,981	58,073	147,935
Change in fair value of insurance and reinsurance contracts	(59,873)	(1,630)	(31,284)
Total revenue	<u>1,230,891</u>	<u>1,017,471</u>	<u>968,782</u>
Expenses:			
Losses and loss expenses incurred	753,158	594,727	567,905
Commission expenses	137,038	122,340	98,172
Other underwriting expenses	137,460	129,389	105,091
Total expenses	<u>1,027,656</u>	<u>846,456</u>	<u>771,168</u>
Income before continuity and other premium credits and income taxes	203,235	171,015	197,614
Continuity and other premium credits	58,817	44,709	37,837
Income before income taxes	<u>144,418</u>	<u>126,306</u>	<u>159,777</u>
Income Taxes:			
Current provision	5,522	(11,535)	17,000
Deferred provision	20,961	37,734	10,050
Total income tax provision	<u>26,483</u>	<u>26,199</u>	<u>27,050</u>
Net Income	<u>\$ 117,935</u>	<u>\$ 100,107</u>	<u>\$ 132,727</u>
Other Comprehensive Income (Loss):			
Unrealized gains (losses) on securities:			
Unrealized holding gains (losses) arising during the year from available-for-sale securities (net of income tax (expense) benefit of (\$7,977), \$16,434, and (\$11,314), respectively)	30,007	(61,610)	21,012
Unrealized holding gains, on held-to-maturity securities reclassified from available-for-sale, arising during the year (net of income tax (expense) of (\$332), (\$504), and (\$577), respectively)	1,251	1,895	1,072
Reclassification adjustment for amounts included in net (loss) income (net of income tax benefit (expense) \$736, (\$10,226), and \$14,132, respectively)	(2,768)	38,471	(26,244)
Other comprehensive income (loss)	<u>28,490</u>	<u>(21,244)</u>	<u>(4,160)</u>
Comprehensive Income	<u>\$ 146,425</u>	<u>\$ 78,863</u>	<u>\$ 128,567</u>

See notes to the consolidated financial statements.

# Associated Electric & Gas Insurance Services Limited

## Consolidated Statements of Changes in Surplus For Years Ended December 31, 2019, 2018 and 2017 (Expressed in thousands of U.S. dollars)

	2019	2018	2017
Statutory Surplus Fund	\$ 250	\$ 250	\$ 250
Policyholders' Surplus:			
Balance at January 1	1,606,780	1,514,832	1,382,105
Cumulative change in accounting principle, net of tax <sup>(*)</sup>	19,008	(8,159)	-
Net income	117,935	100,107	132,727
Balance at December 31	<u>1,743,723</u>	<u>1,606,780</u>	<u>1,514,832</u>
Accumulated Other Comprehensive Income:			
Balance at January 1	29,098	42,183	46,343
Other comprehensive income (loss)	28,490	(21,244)	(4,160)
Reclassification to cumulative change in accounting principle, net of tax <sup>(*)</sup>	<u>(19,008)</u>	<u>8,159</u>	<u>-</u>
Balance at December 31	<u>38,580</u>	<u>29,098</u>	<u>42,183</u>
Total Surplus at December 31	<u>\$ 1,782,553</u>	<u>\$ 1,636,128</u>	<u>\$ 1,557,265</u>

<sup>(\*)</sup> See Note 2s. Accounting Standard Updates 2016-01 and 2018-02 for further details.

See notes to the consolidated financial statements.

# Associated Electric & Gas Insurance Services Limited

## Consolidated Statements of Cash Flows For Years Ended December 31, 2019, 2018 and 2017 (Expressed in thousands of U.S. dollars)

	2019	2018	2017
Cash Flows From Operating Activities:			
Net income	\$ 117,935	\$ 100,107	\$ 132,727
Net investment (gains) losses on securities	(92,424)	52,855	(46,467)
Net investment foreign exchange losses	6,113	758	4,327
Amortization of securities	(5,871)	7,701	5,113
Depreciation and other charges	1,786	2,099	2,473
Deferred income tax expense	20,961	37,733	10,050
Changes in assets and liabilities:			
Due from reinsurers	(349,321)	(266,501)	(271,826)
Due from insureds	(11,510)	(237)	(968)
Accrued interest	(2,982)	555	98
Premiums receivable	(67,105)	(34,516)	(39,924)
Current income taxes receivable	9,183	(19,428)	7,977
Unearned continuity and other premium credits	(2,047)	(3,166)	(3,943)
Prepaid reinsurance premiums	(69,749)	(32,755)	(23,581)
Deferred acquisition costs	(8,849)	(20,756)	(11,209)
Deposit assets	(715)	(1,612)	(3,568)
Other assets	(26,780)	7,994	21,805
Reserve for losses and loss expenses	368,655	353,215	238,357
Unearned premiums	153,403	103,386	51,623
Fair value of insurance and reinsurance contracts	60,571	11,658	36,871
Due to reinsurers	59,662	13,901	23,212
Deposit liabilities	715	1,612	3,568
Accrued expenses and other liabilities	7,694	(1,765)	(44,106)
Net cash provided by operating activities	<u>169,325</u>	<u>312,838</u>	<u>92,609</u>
Cash Flows From Investing Activities:			
Purchases of available-for-sale debt securities, equity securities, and other investments	(3,721,465)	(3,097,491)	(3,014,144)
Purchases of mortgage loans	(53,846)	(44,989)	(154,038)
Purchases of held-to-maturity investments	(199,563)	(149,023)	(234,724)
Proceeds from sales or redemptions of available-for-sale debt securities, equity securities, and other investments	3,747,116	2,821,110	3,125,654
Proceeds from maturities and mandatory redemptions of held-to-maturity investments	182,875	131,848	244,078
Net cash utilized in investing activities	<u>(44,883)</u>	<u>(338,545)</u>	<u>(33,174)</u>
Effect of Exchange Rate Changes on Cash	<u>(670)</u>	<u>2,537</u>	<u>2,275</u>
Increase (Decrease) in Cash and Cash Equivalents	123,772	(23,170)	61,710
Cash and Cash Equivalents, Beginning of Year	<u>265,702</u>	<u>288,872</u>	<u>227,162</u>
Cash and Cash Equivalents, End of Year	<u>\$ 389,474</u>	<u>\$ 265,702</u>	<u>\$ 288,872</u>
Supplemental disclosures of cash flow information:			
Net cash paid (received):			
Income tax payments (receipts)	<u>\$ 3,920</u>	<u>\$ (3,240)</u>	<u>\$ (10,120)</u>

See notes to the consolidated financial statements.



# Associated Electric & Gas Insurance Services Limited

## Notes to the Consolidated Financial Statements (Expressed in thousands of U.S. dollars)

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### 1. The Company and its Principal Activity

Associated Electric & Gas Insurance Services Limited ("AEGIS" or the "Company") was incorporated in Bermuda in 1971 and commenced underwriting activities in 1975. AEGIS is registered as a non-assessable mutual insurance company in Bermuda, is regulated under that country's Insurance Act of 1978, and is a Class 3 insurer under the Insurance Amendment Act of 1995. The Bermuda Monetary Authority approved AEGIS' change in designation from a Class 2 insurer to a Class 3 insurer, effective January 1, 2015.

The principal activity of the Company is to provide, directly and through alliances and affiliates, a full array of liability and property coverages. AEGIS writes Excess Liability, Employers Liability, Employment Practices Liability, Professional Liability, Property, Boiler and Machinery, Cyber and Generation Outage coverage. AEGIS also writes Directors and Officers Liability, Fiduciary and Employee Benefits Liability, and Excess Workers' Compensation coverages. Through strategic alliance partners, which it reinsures, AEGIS offers General Liability, Commercial Automobile Liability, Directors and Officers Liability, Umbrella Liability and Workers' Compensation coverages. The Company operates a federally licensed Canadian branch offering Excess Liability, Directors and Officers Liability, Property, and Boiler and Machinery and Cyber coverages.

AEGIS Electric & Gas International Services Limited ("AISL") is the capital provider for Syndicate 1225 ("AEGIS London") at Lloyd's of London ("Lloyd's"). AISL underwrites primarily Property, Casualty, Specialty Lines, Marine and Energy insurance. AISL is wholly owned by AEGIS through its subsidiary, AEGIS London Holding Limited ("AEGIS London Holding"). Effective January 1, 2012, and continuing through December 31, 2019, the Company provides 93 percent of the net capacity for AEGIS London.

### 2. Significant Accounting Policies

#### a. Basis of Presentation

The consolidated financial statements include the accounts of AEGIS, its wholly owned subsidiaries, and entities over which the Company exercises control and where the Company is considered the primary beneficiary of the entities' activities (these entities are known as variable interest entities ("VIE")). See Note 6 for more information on the Company's consolidated VIEs. The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP"). All significant inter-company transactions are eliminated in consolidation.

#### b. Use of Estimates

The preparation of these consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, in particular investments, reserves for losses and loss expenses, the allowance for uncollectible reinsurance, the fair value of excess workers' compensation direct insurance and related reinsurance contracts, deferred tax assets and liabilities, the disclosure of contingent assets and liabilities at the date of these consolidated financial statements and the amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

#### c. Cash and Cash Equivalents

Cash and cash equivalents generally include demand deposits, money market funds and short-term investments with an original maturity of less than three months from the purchase date. Cash equivalents are carried at amortized cost, which approximates fair value.

# Associated Electric & Gas Insurance Services Limited

## Notes to the Consolidated Financial Statements (Expressed in thousands of U.S. dollars)

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### d. Investments and Mortgage Loans

#### Investments

The Company invests in a variety of financial instruments and vehicles including debt and equity securities, 144A registered and unregistered debt issuances, mutual funds, syndicated bank loans, direct lending, fund of fund investments, convertible debt securities, limited partnership investments, real estate investment trusts ("REIT") and mortgage loans. The Company records its purchases and sales of equity and debt securities and mutual funds on a trade date basis, and all other investments on the contractual effective date. The Company classifies its financial instruments as either Available-for-Sale ("AFS"), Held-to-Maturity ("HTM"), equity securities or other invested assets.

Investment income, net of investment-related expenses, is recognized when earned. Realized investment gains or losses on sales of investments, generally determined on a first-in, first-out basis, are included in net investment income.

Net investment income also includes unrealized gains and losses from convertible debt securities, the change in reported asset value for investments accounted for under the equity method of accounting, and beginning in 2019 unrealized gains and losses from equity securities.

#### Available-for-Sale/Held-to-Maturity Investments

The Company's AFS securities are carried at fair value, with unrealized holding gains and losses, net of income tax effects, included in accumulated other comprehensive income ("AOCI") and the related changes in unrealized gains and losses included in OCI. The amortized cost of debt securities includes both the amortization of premium and the accretion of discounts.

AFS securities include mortgage and asset-backed securities ("MBS" and "ABS" securities, respectively). Amortization of the premium or accretion of the discount from the purchase of these securities is recognized after considering the estimated timing and amount of prepayments of the underlying loans. Actual prepayment experience is periodically reviewed and effective yields are recalculated when differences arise between the prepayments originally anticipated and the actual prepayments received and currently anticipated. The recognition of income on MBS and ABS is dependent upon market conditions, which could result in prepayments and changes in amounts to be earned.

Securities classified as HTM are carried at amortized cost. The Company's intent is to hold its HTM securities to maturity. The HTM portfolio is comprised of various types of securities including domestic and foreign corporate debt instruments, MBS, ABS and private placement issuances.

Securities carried at amortized cost are adjusted for the amortization of premiums and accretion of discounts to maturity using the effective yield method. This amortization and accretion is included in net investment income.

#### Equity Securities

As of January 1, 2019, the Company adopted ASU 2016-01 *Financial Instruments-Overall: (Subtopic 825-10) Recognition and Measurement of Financial Assets and Liabilities* (see Note 2s). Upon adoption, the Company identified its equity investments subject to the accounting standard as equity securities, REITs, and mutual funds. Under the ASU, equity investments remain carried at fair value with changes in fair value beginning January 1, 2019 now being recognized in net investment income on a prospective basis. Any AOCI, as of January 1, 2019, associated with the Company's equity investments was reclassified via a one-time adjustment from AOCI to policyholders' surplus.

# Associated Electric & Gas Insurance Services Limited

## Notes to the Consolidated Financial Statements (Expressed in thousands of U.S. dollars)

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### Other-Than-Temporary-Impairment

The Company periodically reviews its AFS investment portfolios for impairment, which describes a condition where individual holdings have experienced a decline in fair value below their respective amortized costs. The Company considers a number of factors in evaluating whether a decline in fair value below amortized cost is other-than-temporary, including: (a) the present value of expected future cash flows; (b) the financial condition and near-term prospects of the issuer; (c) the period and degree to which the fair value has been below amortized cost; and (d) with respect to AFS debt securities, whether the Company has the intent to sell or will more likely than not be required to sell a particular security before the decline in estimated fair value below its cost or amortized cost recovers. A security is considered other-than-temporarily impaired when it becomes apparent that the present value of the expected cash flows over the expected holding period is less than its amortized cost basis. HTM securities are also periodically reviewed for impairment. Future cash flows and the financial condition of the issuer are the key elements in determining HTM impairment.

Where the decline in fair value of an AFS debt security is deemed to be other-than-temporary and the Company neither intends to sell, nor is it more likely than not that the Company will be required to sell the security, a charge is recorded to net investment income for the credit-related impairments and a new cost basis is established. A decline in fair value for non-credit related impairments is recorded as other comprehensive loss. In periods subsequent to the recognition of an other-than-temporarily impaired loss for debt securities, the discount or reduced premium recorded for the debt security, based on the new cost basis, is amortized over the remaining life of the debt security in a prospective manner based on the amount and timing of future estimated cash flows at the balance sheet date.

The Company's investments are externally managed by professional investment managers who have the discretion to buy and sell securities subject to certain Company-imposed guidelines. Management does not assess, on a security-by-security basis, whether its investment managers had the intent to sell impaired debt securities. Therefore, all impairments of AFS securities as of December 31, 2019 and 2018 were considered other-than-temporary and recorded as a charge to net investment income.

### Syndicated Bank Loans

The Company invests in syndicated bank loans. The initial investment in a bank loan is inclusive of the value of the loans plus or minus any fees paid or received which are directly attributable to the investment. The difference between the initial investment and the related loans principal amount at the date of purchase is recognized as an adjustment to yield over the life of the loan. All other costs incurred in committing to purchase and acquire the loans are expensed as incurred. Syndicated bank loans are classified and treated as AFS securities. As of December 31, 2019 and 2018, the Company's net traded but unsettled syndicated bank loans totaled \$2,015 and \$9,138, respectively, with a corresponding payable for securities purchased.

### REIT Investments

The Company invests in both exchange traded and privately issued REIT investments, both of which are considered equity securities and are classified and accounted for accordingly.

### Other Invested Assets

#### Convertible Debt Securities

The Company invests in convertible debt securities, and in accordance with Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 825, *Financial Instruments*, has elected to apply the fair value option ("FVO") to its portfolio of convertible debt securities. Management elected the FVO as a practical expedient, in order to eliminate the requirement to bifurcate and value the embedded options separately from the host contracts. Convertible securities are carried at fair value and are classified as other invested assets and reported as investments in

# Associated Electric & Gas Insurance Services Limited

## Notes to the Consolidated Financial Statements (Expressed in thousands of U.S. dollars)

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the consolidated balance sheets. The changes in fair value of these securities are recorded in net investment income in the period the change occurs.

### **Investments Accounted for Under the Equity Method**

When the Company does not have a controlling financial interest in an entity but can exert what is deemed as significant influence, generally based on percentage of ownership, the entity is accounted for under the equity method of accounting. The following investments are accounted for under the equity method and are included in investments in the consolidated balance sheet with income recorded as net investment income.

#### **Fund of Funds**

The Company invests in fund of funds investments and these investments are accounted for using the equity method of accounting. Under the equity method of accounting, the carrying value of these holdings approximates fair value.

#### **Limited Partnership Investments**

The Company invests in limited partnerships whose underlying investments are comprised of various types of instruments, such as senior secured term loans, senior floating rate debt and syndicated bank loans. The ownership interest in each of the limited partnerships exceeded 5% but was less than 50% at December 31, 2019 and 2018. Based on its percentage of ownership, the Company is accounting for these investments using the equity method of accounting, in accordance with ASC 323, *Investments—Equity Method and Joint Ventures*. Under the equity method of accounting, the carrying value of these instruments approximates fair value.

#### **Mortgage Loans**

The Company participates in residential and commercial mortgage loans by investing in a pro-rata interest in loans originated by a third party. Residential loans are comprised mostly of apartment complexes, while commercial loans consist largely of malls and commercial buildings. Mortgage loans are stated at the unpaid principal balance adjusted for deferred fees and are net of a valuation allowance. Commitment and other deferred fees are recognized as income on a straight-line basis over the life of the loan. Interest income is recognized as earned and management fees are expensed as incurred, with both reflected in net investment income.

#### **Security Lending Agreements**

The Company participates in securities lending arrangements whereby specific securities are loaned to other institutions, primarily banks and brokerage firms, for short periods of time. Collateral is held by our custodian and is monitored and maintained by the lending agent. Company policy requires the borrower to provide a minimum of 102% up to 105% of the fair value of the domestic and foreign loaned securities, respectively, as collateral. Securities loaned are recorded in accrued expenses and other liabilities, while cash collateral held by our custodian and monitored and maintained by the lending agent is recorded in other assets on the consolidated balance sheets. The Company receives interest income on the invested collateral, which is included in net investment income. The Company monitors the fair value of the underlying securities to ensure such transactions are adequately collateralized.

#### **e. Concentration of Credit Risk**

Financial instruments that potentially subject the Company to concentrations of credit risk include cash balances in excess of government-insured limits, amounts due from reinsurers and marketable debt securities. Although the Company places its temporary cash investments with creditworthy financial institutions and purchases reinsurance contracts from highly rated reinsurers, the Company is exposed to a concentration of credit risk with respect to cash and temporary cash investments held at financial

# Associated Electric & Gas Insurance Services Limited

## Notes to the Consolidated Financial Statements (Expressed in thousands of U.S. dollars)

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institutions and amounts due from its reinsurers. Management monitors the credit standing of the relevant financial institutions and the financial condition of the Company's reinsurers.

The Company holds bonds and notes issued by U.S. and foreign corporations, the United States government and foreign governments. By policy, these investments are kept within limits designed to prevent risks caused by concentration. As of December 31, 2019 and 2018, there were no known significant concentrations of credit risk with regard to invested assets.

### **f. Deferred Acquisition Costs**

The Company incurs brokers' commissions and premium taxes in acquiring insurance premiums for executed contracts. These costs are deferred and amortized over the lives of the policies to which they relate, excluding contracts measured at fair value, where such costs are included in commission expense in the year inception. The amortization of deferred acquisition costs is included in commission expenses. The recoverability of these deferred costs is reviewed periodically and includes the consideration of future investment income.

### **g. Derivative Financial Instruments**

The Company uses foreign currency forward contracts, generally with terms of 90 days or less. The primary objective of investing in foreign currency forward contracts is to protect the U.S. dollar value of foreign currency-denominated monetary assets and liabilities from the effects of volatility in foreign exchange rates that might occur prior to their receipt or settlement in U.S. dollars. These forward contracts are not designated as hedges and are marked to fair value through net investment income and substantially offset the change in spot value of the underlying foreign currency-denominated monetary asset or liability.

The Company's foreign currency forward contracts are traded in the over-the-counter derivative market. These contracts are valued by models that utilize actively quoted or observable market input values from external market data providers, third party pricing vendors and/or recent trading activity, and therefore would be classified as a Level 2 investment.

As of December 31, 2019 and 2018, the Company invested in foreign currency forward contracts with a notional balance of \$25,000, respectively, denominated in Canadian dollars. As of December 31, 2017, the Company had no outstanding derivative contracts. The (loss)/gain recorded from foreign currency forward contracts for 2019, 2018 and 2017 was (\$1,018), \$546 and \$0, respectively, which is reflected in net investment income.

### **h. Foreign Operations and Foreign Currency Translation**

The functional and reporting currency of the Company is U.S. dollars. Monetary assets and liabilities denominated in foreign currencies are translated at the rate of exchange in effect at the balance sheet date. Revenues and expenses are translated at the average rate prevailing during the year. Any resulting operating foreign exchange gain or loss is included in other underwriting expenses. The Company recorded net operating foreign exchange gains (losses) of \$3,136, (\$2,745) and \$3,907 for the years ended December 31, 2019, 2018 and 2017, respectively. Unrealized gains and losses resulting from changes in the foreign currency exchange rates on AFS securities are recorded in the consolidated balance sheets in AOCI. Realized foreign currency gains and losses resulting from the sale of securities are recorded in net investment income.

AISL's assets, liabilities, revenues and expenses are recorded after making certain adjustments to convert U.K. GAAP accounting to U.S. GAAP. The most significant U.S. GAAP adjustments relate to timing of investment income recognition and loss reserve estimates.

The Canadian branch files statutory financial statements based upon International Financial Reporting Standards. The most significant U.S. GAAP adjustments to the Canadian branch relate to the method of estimation of loss reserves.

# Associated Electric & Gas Insurance Services Limited

## Notes to the Consolidated Financial Statements (Expressed in thousands of U.S. dollars)

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### **i. Income Taxes**

The Company's provision for income taxes represents management's best estimate of various events and transactions and includes the impact of reserve provisions and changes to reserves that are considered appropriate. The Company reflects interest and penalties attributable to income taxes, to the extent they arise, as a component of its income tax provision or benefit as well as its outstanding income tax assets and liabilities.

Deferred tax assets and liabilities resulting from temporary differences between the financial reporting and tax bases of assets and liabilities are measured at the balance sheet date using enacted tax rates expected to apply to taxable income in the years the temporary differences are expected to reverse. A valuation allowance is established when it is more likely than not that some portion of the Company's deferred tax assets will not be realized.

Significant judgment is required in evaluating the Company's tax positions and determining its provision for income taxes as there are many transactions and calculations for which the ultimate tax determination is uncertain. The assessment to determine whether a valuation allowance is required and the amount of any allowance requires significant judgment and includes the long-range forecast of future taxable income and the evaluation of tax planning initiatives. Adjustments to the deferred tax valuation allowances are recorded in earnings in the period such management assessments are made.

The Company recognizes a tax benefit relating to uncertain tax positions only where the position is more likely than not to be sustained assuming examination by tax authorities. The Company establishes reserves for tax-related uncertainties based on estimates of whether, and the extent to which, additional taxes will be due. These reserves are established when the Company believes that certain positions might be challenged despite its belief that the Company's tax return positions are fully supportable. The Company adjusts these reserves in light of changing facts and circumstances, such as the outcome of tax audits.

On December 22, 2017, the Tax Cuts and Jobs Act ("TCJA") was enacted. The TCJA reduced the corporate tax rate from 35% to 21% effective January 1, 2018 and enacted other changes impacting the Company. The Company completed its accounting for the effects of the law change during 2018.

### **j. Written and Unearned Premiums**

Premiums are earned as income ratably over the period covered by the policies. Unearned premium reserves are established relative to the unexpired contract period. It is the Company's practice to price certain of its policies at amounts that are not expected to fully recover anticipated losses, loss expenses and underwriting expenses. Such practice anticipates that sufficient investment income will be earned over the period in which underwriting losses are settled.

### **k. Reserve for Losses and Loss Expenses**

The reserve for losses and loss expenses represents the Company's best estimate, based on its latest studies, of the gross amount of losses and loss expenses to be paid on ultimate settlement of all incurred insurance claims, reported and unreported, as of the respective balance sheet dates. These estimates are periodically reviewed by the Company's management and independent actuaries, and are adjusted in accordance with the latest available information. Any adjustments in estimates are reflected in earnings in the period the adjustment is recorded. Management believes that an adequate provision has been made for the Company's losses and loss expenses.

### **l. Fair Value Measurements**

The Company measures certain assets and liabilities using fair value. Fair value is a market-based measurement and not an entity-specific measurement, and requires the use of a fair value hierarchy with the highest priority given to quoted prices in active markets. Fair value is defined as the price

# Associated Electric & Gas Insurance Services Limited

## Notes to the Consolidated Financial Statements (Expressed in thousands of U.S. dollars)

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that would be received to sell an asset or paid to transfer a liability (i.e., the exit price) in an orderly transaction between market participants at the measurement date. In determining fair value, the Company uses various valuation approaches. Assets and liabilities measured and reported at fair value are classified and disclosed in one of the following categories:

**Level 1**—Quoted prices available in active markets for identical investments as of the reporting date are used to determine fair value. Assets measured at fair value and classified as Level 1 include publicly traded equity securities.

**Level 2**—Pricing inputs other than quoted prices in active markets, which are either directly or indirectly observable as of the reporting date, are used to determine fair value through the use of models or other valuation methodologies. Assets measured at fair value and classified as Level 2 include certain domestic and foreign government and agency securities, domestic and foreign corporate bonds, MBS, ABS, syndicated bank loans/direct lending, commercial paper, secured notes, mutual funds, and certain private placements. Since many debt securities do not trade on a daily basis, independent pricing services estimate fair value through processes such as bid evaluation using observable inputs and matrix pricing of similar securities to calculate the fair value of domestic and foreign government and agency securities. For domestic and foreign corporate bonds and commercial paper, the pricing provider considers credit spreads, interest rate data and market analysis in the valuation of each security. For MBS and ABS, the pricing provider applies models including observable inputs such as dealer quotes and other available trade information as well as prepayment speeds, yield curves and credit spreads. Syndicated bank loans are priced using dealer quotes relying on available market data.

**Level 3**—Significant pricing inputs are unobservable and include situations where there is little, if any, observable market activity for the investment, asset or obligation. The liability for the fair value of excess workers' compensation insurance and reinsurance contracts is classified as Level 3. Management must make assumptions about inputs that a market participant would use to value the liability. If quoted market prices are not available, fair value is based upon vendor or internally developed valuation models that use, where possible, current market-based or independently sourced market parameters. In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the level in the fair value hierarchy is determined based on the lowest-level input that is significant to the fair value measurement in its entirety. There have been no material changes in the Company's valuation techniques during the periods presented. The Company also considers its own nonperformance risk when measuring the fair value of liability positions and the counterparty's nonperformance risk when measuring the fair value of asset positions.

### **Fair Value Option for Insurance and Reinsurance Contracts**

Effective January 1, 2008, the Company elected the FVO for all direct insurance contracts classified as excess workers' compensation, as well as the related reinsurance contracts.

The Company records these contracts at fair value to reflect the significant elapsed time between the issuance of the contracts and final settlement of the obligations, adjusted for the risk of variation in the amount and timing of future cash flows. These contracts are recorded at fair value, with changes in fair value recorded in the consolidated statements of income and comprehensive income in the period of change. As such, reported premiums and incurred losses do not include activity related to the Company's excess workers' compensation insurance and reinsurance contracts.

Cash flows from the underlying insurance and reinsurance contracts are reported in cash flows from operating activities. Management reevaluates, on an annual basis, its fair value election for future insurance and reinsurance contracts.

### **m. Continuity and Other Premium Credits**

Continuity credits are based on each respective member's proportionate share of premiums and total surplus. Other premium credits are based on each eligible policyholders' proportionate share of its premiums for the given measurement period. Continuity and other premium credits are declared by

# Associated Electric & Gas Insurance Services Limited

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the Company's Board of Directors. Such credits are provided only to eligible members and other policyholders renewing coverage with the Company and are subject to certain restrictions. The application of continuity and other premium credits to policy renewal premiums is limited to the amount of premium charged. Excess credits are carried forward for potential use in future periods; such credits are forfeited when a member chooses not to renew its policy with the Company. Issued credits are earned over the periods covered by the underlying policies.

### n. Reinsurance

The Company cedes a portion of its insurance risk by utilizing various reinsurance contracts in order to provide additional capacity for future growth and limit the maximum net loss potential arising from the severity or frequency of insurance claims. These contracts do not relieve the Company from its obligation to policyholders. The amounts recoverable from reinsurers are estimated in a manner consistent with the reserve for losses associated with the related reinsurance contract.

### o. Deposit Assets and Liabilities

The Company enters into certain contracts that do not meet U.S. GAAP risk transfer provisions requiring that a transaction contain a significant assumption of insurance risk and a reasonable possibility that the Company may realize a significant loss from the contract. These contracts are accounted for using the deposit method of accounting. For these contracts, the Company records deposit liabilities for an amount equivalent to the assets received with any differences due to the timing of receipts and payments. In some cases, the Company transfers assets to another insurer or reinsurer and records a deposit asset for the amount paid.

### p. Property and Equipment

Property, equipment, and leasehold improvements are stated at cost less accumulated depreciation/amortization and are included in other assets. Depreciation/amortization are provided, beginning at the inception of the asset's use, under the straight-line method based upon the following estimated useful lives:

	Estimated Life (Years)
Property and leasehold improvements	(*)
Furniture and fixtures	5–15
Information technology equipment and software	3–5

(\*) *Amortized over the lesser of the useful life or the remaining life of the lease from the date placed in service*

A summary of property and equipment at December 31 is as follows:

	2019	2018
Property and leasehold improvements	\$ 8,244	\$ 8,244
Furniture and fixtures	3,390	3,583
Information technology equipment and software	19,315	20,475
Total cost	30,949	32,302
Accumulated depreciation/amortization	(27,269)	(27,480)
Net property and equipment	\$ 3,680	\$ 4,822

Depreciation expense amounted to \$1,786, \$2,099 and \$2,473 for the years ended December 31, 2019, 2018 and 2017, respectively. There were no gains related to the disposal of the Company's property and equipment during the years ended 2019, 2018 and 2017.



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### q. Retirement Benefit Plans

Prior to January 1, 1998, the Company maintained a qualified defined benefit pension plan for eligible employees of AEGIS Insurance Services, Inc., a wholly owned subsidiary of the Company, through membership in the Pension Plan for Employees of AEGIS Insurance Services, Inc. (the "Pension Plan"). Benefits are based on a participant's credited service ending no later than December 31, 2011, as defined by the Pension Plan. On January 1, 1998, the Pension Plan was frozen to new participants.

Effective December 31, 2011, the Pension Plan was amended to discontinue the accrual of additional participant benefits after December 31, 2011. On July 15, 2012, the Pension Plan was amended for a one-time adjustment, which increased frozen Participant's accrued benefit base by 10% provided the participant was an active employee on July 31, 2012. The Company also has a non-qualified supplemental defined benefit plan for certain employees. The non-qualified plan is funded from the general assets of the Company, including corporate-owned life insurance policies purchased to provide for the benefits earned by eligible employees; however, these policies cannot be considered in the determination of the funded status of the non-qualified plan.

The Company's funding policy is to contribute funds to the Pension Plan, as necessary, to provide for any unfunded projected benefit obligation over a reasonable period. To the extent that these requirements are fully covered by assets in the Pension Plan, the Company may elect not to make any contributions in a particular year. As of December 31, 2019 and 2018, the total projected benefit obligation for the Pension Plan and the non-qualified plan was \$39,111 and \$36,745, respectively. The fair value of Pension Plan assets as of December 31, 2019 and 2018 was \$29,033 and \$26,540, respectively, and the total unfunded balance was \$10,077 and \$10,205, respectively. The Company's projected benefit obligations were based on discount rates blended, as described below, for the Pension Plan and 2.75% for the non-qualified plan for 2019, 4.25% for the Pension Plan and 3.50% for the non-qualified plan for 2018, with a 3.00% rate of compensation increase for the non-qualified Plan in 2019 and 2018. The expected rate of return on Pension Plan assets was 3.50% for 2019 and 2018, and is determined based on historical and expected future returns of the Pension Plan's asset classes.

On June 5, 2019, the Pension Plan was terminated effective September 30, 2019. No cash distributions will be made to participants until a favorable determination letter is obtained from the Internal Revenue Service and an asset distribution date is determined, which is the effective date that the Company purchases a group annuity contract that will pay all Pension Plan benefits. The actuarial assumptions regarding the Pension Plan's projected benefit obligations assume the Pension Plan will be liquidated in 2020, therefore the effective discount rate used was a blended rate.

The Company currently maintains a post-retirement medical benefit plan for eligible employees of the Company, and benefits are based on a participant's age and credited service. In 2012, the Plan was amended to reduce the Company's share of the costs if the annual premium increase exceeds 3.00%. The Plan benefits are funded from the general assets of the Company, including corporate-owned life insurance policies purchased to provide for the benefits earned by eligible employees. These policies cannot be considered in the determination of the funded status of the plan. As of December 31, 2019 and 2018, the unfunded balance related to this plan was \$9,895 and \$9,172, respectively. The Company's obligations under the plan were based upon a discount rate of 3.50% for 2019 and 4.50% for 2018.

All unfunded balances for the plans above are recorded within accrued expenses and other liabilities within the consolidated balance sheets.

### r. Reclassifications

The Company has reclassified certain prior year amounts to conform to the current year's presentation.

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## Notes to the Consolidated Financial Statements (Expressed in thousands of U.S. dollars)

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### s. New Accounting Pronouncements

#### *Adoption of New Accounting Pronouncements*

In May 2014, the FASB issued a comprehensive new revenue recognition standard ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*, deferred by ASU 2015-14, resulting in a new effective date for nonpublic entities for annual reporting periods beginning after December 15, 2018. The new guidance supersedes the previous revenue recognition guidance under U.S. GAAP. For those contracts that are impacted by the new guidance an entity is required to recognize revenue upon the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled, in exchange for those goods or services. The Company identified revenue streams within the scope of this guidance and based on an analysis performed on selected contracts, it was determined that there would be no impact or significant shift in the timing of recognizing revenues derived from the performance of these services (underwriting and claims management, loss control and structured settlement services). The Company adopted this ASU in 2019 and this guidance had no impact on the Company's consolidated financial statements.

In January 2016, the FASB issued updated guidance ASU 2016-01, *Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities* as clarified and amended by ASU 2018-03, *Technical Corrections and Improvements to Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*. This guidance changes an entity's accounting associated with the classification and measurement of certain equity investments and the presentation of certain fair value changes for financial liabilities measured at fair value. The guidance also amends certain disclosure requirements associated with the fair value of financial instruments. The Company adopted this ASU in 2019, under the retrospective method, and identifies its equity investments as equity securities, REITs and mutual funds. On January 1, 2019, the Company reclassified \$19,008 of unrealized gains related to equity investments subject to ASU 2016-01, net of income taxes, from AOCI to policyholders' surplus based on the accounting guidance requirements of ASU 2016-01.

In August 2016, the FASB issued guidance ASU 2016-15, *Statement of Cash Flows (Topic 230) Clarification of Certain Cash Receipts and Cash Payments*, which addresses the practice of how certain cash receipts and payments are presented and classified in the statement of cash flows, including distributions received from equity method investments. The guidance requires entities to make an accounting policy election to present cash flows received as either in operating or investing cash flows. The Company adopted this ASU in 2019 and based on the current presentation of cash payments and receipts and the nature of equity method investment distributions, the implementation of this ASU had no impact on the Company's consolidated statement of cash flows.

In November 2016, the FASB issued guidance ASU 2016-18, *Statement of Cash Flows (Topic 230) Restricted Cash*, which provides guidance on the presentation of restricted cash or restricted cash equivalents in the statement of cash flows. The Company adopted this ASU in 2019 and implementation of this ASU has no impact on the Company's consolidated statement of cash flows.

In March 2017, the FASB issued new guidance on the presentation of net periodic pension cost and net periodic postretirement benefit cost ASU 2017-07, *Compensation—Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*. The guidance requires that an employer that has defined benefit pension or other postretirement benefit plans report the service cost component in the same financial statement line item or items as other compensation costs. In addition, the guidance allows only the service cost component to be eligible for capitalization when applicable. The guidance should be applied retrospectively for the presentation of the service cost component in the income statement, and prospectively for the capitalization of the service component. The Company adopted this ASU in 2019 which had an immaterial impact on the Company's consolidated financial statements.

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## Notes to the Consolidated Financial Statements (Expressed in thousands of U.S. dollars)

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In February 2018, the FASB issued new guidance on reporting comprehensive income ASU 2018-02, *Income Statement-Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from AOCI (Topic 220)*. The guidance was issued in direct response to the issuance of TCJA, and the ensuing request for guidance around the treatment of “stranded tax effects” caused by TCJA. Under the new law, one of the provisions was the reduction of Federal corporate tax rates from 35% to 21%. This had the result of reducing the carrying value of reporting entities’ net deferred tax assets. One large component of deferred taxes that many entities carry is a deferred tax asset or liability for unrealized gains and losses on investments, the offset of which is recognized in either net income or AOCI, depending upon the accounting for the underlying investments. ASC 740 required that all tax effects from changes in tax law and regulations be recorded to the consolidated statement of income, however a portion of any deferred tax on unrealized gains and losses on investments that is recorded within AOCI was considered “stranded”. ASU 2018-02 allows reporting entities to reclassify these stranded tax effects from AOCI to policyholders’ surplus. In 2018, the Company implemented this ASU resulting in an increase to AOCI and a reduction in policyholders’ surplus of \$8,159 on an aggregate portfolio basis as of December 31, 2018.

### **Future Adoption of New Accounting Pronouncements**

In February 2016, the FASB issued updated guidance ASU 2016-02, *Leases (Topic 825-10)*, as clarified and amended by ASU 2018-10, *Codification Improvements to Topic 842, Leases*, ASU 2018-11, *Leases (Topic 842): Targeted Improvements*, and ASU 2018-20, *Leases (Topic 842): Narrow Scope Improvements for Lessors*, and in January 2019, the FASB issued updated guidance ASU 2019-01, *Leases (Topic 842), Codification Improvements*, which supersedes existing lease accounting guidance. The ASUs collectively are effective for nonpublic entities for annual reporting periods beginning after December 15, 2020. Early adoption is permitted. The guidance requires the lessee recognize both assets and liabilities for leases with lease terms of more than 12 months. Consistent with the current guidance, leases would be classified as a finance or operating lease. However, the new guidance requires both types of leases to be recognized on the balance sheet. The adoption of this guidance is not expected to have a material impact on the Company’s financial condition or results of operations. The most significant impact will be to the balance sheet resulting from the establishment of a right of use asset and a corresponding lease liability for the real estate leases.

In November 2018, the FASB issued ASU 2018-19 clarifying how operating leases should be accounted for in accordance with *Topic 842, Leases*. This guidance also amends the current debt security other-than-temporary impairment model by requiring an estimate of the expected credit loss only when the fair value is below the amortized cost. The AFS security model will also require the use of a valuation allowance as compared to the current practice of writing down an asset. The Company is currently assessing the impact of the new pronouncement on the consolidated financial statements and required disclosure.

In August 2018, the FASB issued new guidance on fair value measurement ASU 2018-13, *Fair Value Measurement (Topic 820): Disclosure Framework—Changes to the Disclosure Requirements for Fair Value Measurement*. The new guidance is effective for fiscal years beginning after December 15, 2019. Early adoption is permitted. The guidance modifies the disclosure requirements on fair value by removing some requirements, modifying others, adding changes in unrealized gains and losses included in OCI for recurring Level 3 fair value measurements, and providing the option to disclose certain other quantitative information with respect to significant unobservable inputs in lieu of a weighted average. The Company is currently evaluating the impact of the new guidance on its consolidated financial statements and believes the implementation will have an impact on its footnote disclosures.

In August 2018, the FASB issued new guidance on defined benefit pension or other postretirement plans ASU 2018-14, *Compensation—Retirement Benefits—Defined Benefit Plans—General (Subtopic 715-20): Disclosure Framework—Changes to the Disclosure Requirements for Defined Benefit Plans*. The new guidance is effective for fiscal years ending after December 15, 2021. Early adoption is permitted. The new guidance should be applied on a retrospective basis to all periods presented. The new guidance adds, modifies and clarifies certain disclosure requirements relevant to sponsored

# Associated Electric & Gas Insurance Services Limited

## Notes to the Consolidated Financial Statements (Expressed in thousands of U.S. dollars)

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defined benefit pension or other postretirement plans. The Company is currently evaluating the impact of the new guidance on its consolidated financial statements.

In August 2018, the FASB issued new guidance on intangibles ASU 2018-15, *Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract*. The new guidance requires a customer in a cloud computing arrangement that is a service contract to follow the internal-use software guidance to determine which implementation costs to capitalize as an asset and which costs to expense as incurred. Implementation costs that are capitalized under the new guidance are required to be amortized over the term of the hosting arrangement, beginning when the module or component of the hosting arrangement is ready for its intended use. The new guidance is effective for fiscal years ending after December 15, 2020. Early adoption is permitted. The new guidance is to be applied either retrospectively or prospectively to all implementation costs incurred after the date of adoption. The Company does not expect the implementation of this guidance to have a material impact on its consolidated financial statements.

In June 2016, the FASB issued guidance ASU 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*, as clarified and amended by ASU 2018-19, *Codification Improvements to Topic 326, Financial Instruments—Credit Losses*, ASU 2019-04, *Codification Improvements to Topic 326, Financial Instruments—Credit Losses, Topic 815, Derivatives and Hedging, and Topic 825, Financial Instruments*, ASU 2019-05, *Financial Instruments—Credit Losses (Topic 326): Targeted Transition Relief*, ASU 2019-11, *Codification Improvements to Topic 326, Financial Instruments—Credit Losses*, and ASU 2020-02 *Financial Instruments—Credit Losses (Topic 326) and Leases (Topic 842)*. Collectively, this ASU replaces the incurred loss accounting framework for financial instrument credit losses with one that employs a current expected credit loss (“CECL”) methodology. Under this ASU, the measurement of credit losses is determined based on historical information, current conditions, as well as reasonable and supportable forecasts, and an allowance for credit losses must be established that is deducted from the amortized cost basis of the financial asset in order to present the net carrying value of the financial asset on the consolidated balance sheet at an amount expected to be collected.

The new guidance requires an allowance for credit losses based on the expectation of lifetime credit losses on financing receivables carried at amortized cost, including, but not limited to, mortgage loans, premium receivables, reinsurance receivables and leases other than operating leases. The current model for OTTI on AFS debt securities has been modified and requires the recording of an allowance for credit losses instead of a reduction of the carrying value. Any improvements in expected future cash flows will no longer be reflected as a prospective yield adjustment, but instead will be reflected as a reduction in the allowance. The new guidance also replaces the model for purchased credit impaired debt securities and financing receivables and requires the establishment of an allowance for credit losses at acquisition, which is deducted from the purchase price to establish the initial amortized cost of the instrument. The new guidance also requires enhanced disclosures and is effective for fiscal years ending after December 15, 2022. Early adoption is permitted. The new guidance is to be applied retrospectively, by means of a cumulative-effect adjustment to the opening balance of policyholders' surplus in the statement of financial positions after the date of adoption of this ASU. The Company is currently evaluating the impact of the new guidance on its consolidated financial statements.

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## Notes to the Consolidated Financial Statements (Expressed in thousands of U.S. dollars)

### 3. Investments

The fair value of the Company's investments compared with their cost or amortized cost were:

	December 31, 2019				Value on Balance Sheet
	Cost/ Amortized Cost	Gross Unrealized		Fair Value	
		Gains	Losses (*)		
<b>Held-to-maturity:</b>					
Debt securities:					
U.S. corporate debt securities	\$ 602,981	\$ 17,674	\$ (512)	\$ 620,143	\$ 602,981
Foreign corporate debt securities	131,710	1,740	(111)	133,339	131,710
Agency MBS	383,810	4,986	(3,405)	385,391	383,810
Non-agency MBS and ABS	125,754	1,229	(1,971)	125,012	125,754
Total HTM investments	<u>1,244,255</u>	<u>25,629</u>	<u>(5,999)</u>	<u>1,263,885</u>	<u>1,244,255</u>
<b>Available-for-sale:</b>					
Debt securities:					
U.S. Treasury securities and obligations of U.S. government corporations and agencies	240,105	1,001	-	241,106	241,106
Debt securities issued by foreign governments	283,514	6,658	-	290,172	290,172
U.S. corporate debt securities	737,432	16,339	-	753,771	753,771
Foreign corporate debt securities	171,385	3,397	-	174,782	174,782
Agency MBS	237,939	6,406	-	244,345	244,345
Non-agency MBS and ABS	190,676	1,667	-	192,343	192,343
Syndicated bank loans/Direct lending	235,272	4,995	-	240,267	240,267
Total AFS investments	<u>2,096,323</u>	<u>40,463</u>	<u>-</u>	<u>2,136,786</u>	<u>2,136,786</u>
<b>Equity securities(**):</b>					
Equity securities/REITs	179,629	26,483	-	206,112	206,112
Mutual fund bonds	263,325	2,892	-	266,217	266,217
Total equity securities	<u>442,954</u>	<u>29,375</u>	<u>-</u>	<u>472,329</u>	<u>472,329</u>
<b>Other invested assets(**):</b>					
Limited partnership/Direct lending	174,316	666	(580)	174,402	174,402
Convertible securities	80,546	8,497	(1,195)	87,848	87,848
Fund of funds	593	3	(3)	593	593
Total other invested assets	<u>255,455</u>	<u>9,166</u>	<u>(1,778)</u>	<u>262,843</u>	<u>262,843</u>
<b>Total investments</b>	<u>\$ 4,038,987</u>	<u>\$ 104,633</u>	<u>\$ (7,777)</u>	<u>\$ 4,135,843</u>	<u>\$ 4,116,213</u>
<b>Mortgage loans</b>	<u>\$ 198,482</u>	<u>\$ N/A</u>	<u>\$ N/A</u>	<u>\$ 201,428</u>	<u>\$ 198,482</u>
<b>Cash and cash equivalents</b>	<u>\$ 389,474</u>	<u>\$ N/A</u>	<u>\$ N/A</u>	<u>\$ 389,474</u>	<u>\$ 389,474</u>

(\*) As of December 31, 2019, no gross unrealized losses are reported for AFS investments, as these unrealized losses are treated as other-than-temporary impairment adjustments and are recorded as a deduction in net investment income and the amortized cost of investments. HTM securities are held at cost/amortized cost.

(\*\*) All gains and losses associated with equity securities and other invested assets are recorded in net investment income.

N/A—Not Applicable

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	December 31, 2018				
	Cost/ Amortized Cost	Gross Unrealized		Fair Value	Value on Balance Sheet
		Gains	Losses (*)		
<b>Held-to-maturity:</b>					
Debt securities:					
U.S. corporate debt securities	\$ 651,063	\$ 1,962	\$ (13,208)	\$ 639,817	\$ 651,063
Foreign corporate debt securities	111,177	53	(2,709)	108,521	111,177
Agency MBS	404,017	409	(16,082)	388,344	404,017
Non-agency MBS and ABS	123,691	62	(5,993)	117,760	123,691
Total HTM investments	<u>1,289,948</u>	<u>2,486</u>	<u>(37,992)</u>	<u>1,254,442</u>	<u>1,289,948</u>
<b>Available-for-sale:</b>					
Debt securities:					
U.S. Treasury securities and obligations of U.S. government corporations and agencies	188,667	168	-	188,835	188,835
Debt securities issued by foreign governments	250,564	126	-	250,690	250,690
U.S. corporate debt securities	542,570	673	-	543,243	543,243
Foreign corporate debt securities	189,029	150	-	189,179	189,179
Agency MBS	329,697	746	-	330,443	330,443
Non-agency MBS and ABS	114,795	883	-	115,678	115,678
Syndicated bank loans/Direct lending	291,651	257	-	291,908	291,908
Total AFS investments	<u>1,906,973</u>	<u>3,003</u>	<u>-</u>	<u>1,909,976</u>	<u>1,909,976</u>
<b>Equity Securities:</b>					
Equity securities/REITs	321,650	23,926	-	345,576	345,576
Mutual funds:					
Equity	119,243	-	-	119,243	119,243
Bonds	158,592	134	-	158,726	158,726
Total mutual funds	<u>277,835</u>	<u>134</u>	<u>-</u>	<u>277,969</u>	<u>277,969</u>
Total equity securities	<u>599,485</u>	<u>24,060</u>	<u>-</u>	<u>623,545</u>	<u>623,545</u>
<b>Other invested assets(**):</b>					
Limited partnership/Direct lending	97,188	693	(1,930)	95,951	95,951
Convertible securities	79,550	2,289	(4,521)	77,318	77,318
Fund of funds	548	3	(3)	548	548
Total other invested assets	<u>177,286</u>	<u>2,985</u>	<u>(6,454)</u>	<u>173,817</u>	<u>173,817</u>
<b>Total investments</b>	<u>\$ 3,973,692</u>	<u>\$ 32,534</u>	<u>\$ (44,446)</u>	<u>\$ 3,961,780</u>	<u>\$ 3,997,286</u>
<b>Mortgage loans</b>	<u>\$ 172,576</u>	<u>\$ N/A</u>	<u>\$ N/A</u>	<u>\$ 173,633</u>	<u>\$ 172,576</u>
<b>Cash and cash equivalents</b>	<u>\$ 265,702</u>	<u>\$ N/A</u>	<u>\$ N/A</u>	<u>\$ 265,702</u>	<u>\$ 265,702</u>

(\*) As of December 31, 2018, no gross unrealized losses are reported for AFS investments and equity securities, as these unrealized losses are treated as other-than-temporary impairment adjustments and are recorded as a deduction in net investment income and the amortized cost of investments. HTM securities are held at cost/amortized cost.

(\*\*) All gains and losses associated with other invested assets are recorded in net investment income.

N/A—Not Applicable

# Associated Electric & Gas Insurance Services Limited

## Notes to the Consolidated Financial Statements (Expressed in thousands of U.S. dollars)

### Available-for-Sale Investments and Equity Securities

The Company's AFS and equity securities activities for the years ended December 31, were as follows:

	2019	2018	2017
Purchases	\$ 3,573,545	\$ 2,965,174	\$ 2,960,805
Proceeds from sales	2,335,192	1,510,549	2,181,555
Gross gains	80,191	36,546	53,392
Gross losses <sup>(*)</sup>	10,818	89,844	13,659
Other-than-temporary impairment recognized	2,833	83,212	8,565

(\*) Gross losses includes other-than-temporary impairments recognized

### Held-to-Maturity Investments

Proceeds from maturities of HTM investments were \$145,040, \$100,251 and \$105,918 for the years ended December 31, 2019, 2018 and 2017, respectively. As these proceeds resulted from the maturity of securities, there were no gains or losses recognized related to these HTM investments.

### Other-Than-Temporary Impairments

The evaluation for other-than-temporary impairments is a quantitative and qualitative process that is subject to risks and uncertainties in the determination of whether declines in the fair value of investments are other-than-temporary. The risks and uncertainties include changes in general economic conditions, the issuer's financial condition or near-term recovery prospects, and the effects of changes in interest rates over the period of time the investment is expected to be held. As of December 31, 2019, 2018 and 2017, the Company evaluated all securities for credit-related impairment and concluded all significant unrealized losses were included in the other-than-temporary impairment charge for AFS securities. As of December 31, 2019 and 2018, none of the Company's HTM securities were impaired.

### Maturities of Debt Securities

The amortized cost and fair value of AFS and HTM debt securities at December 31, 2019, by contractual maturity, are shown in the following table. As MBS and ABS are generally more likely to be prepaid than other fixed maturity securities, MBS and ABS are shown separately.

	Available-for-Sale		Held-to-Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	\$ 327,360	\$ 328,725	\$ 149,779	\$ 150,105
Due after one year through five years	1,064,322	1,087,263	385,443	391,294
Due after five years through ten years	251,432	259,538	47,810	49,701
Due after ten years	24,594	24,572	151,659	162,382
Subtotal	1,667,708	1,700,098	734,691	753,482
Agency MBS	237,939	244,345	383,810	385,391
Non-agency MBS and ABS	190,676	192,343	125,754	125,012
Total debt securities	<u>\$ 2,096,323</u>	<u>\$ 2,136,786</u>	<u>\$ 1,244,255</u>	<u>\$ 1,263,885</u>

# Associated Electric & Gas Insurance Services Limited

## Notes to the Consolidated Financial Statements (Expressed in thousands of U.S. dollars)

Expected maturities will differ from stated maturities because underlying borrowers have the right to call or prepay certain obligations with or without prepayment penalties.

The Company's participation in securities lending arrangements as of December 31, 2019 and 2018, was comprised of investment securities on loan having a fair value of \$6,937 and \$7,082, respectively, while the cash collateral from borrowers was \$7,080 and \$7,246 as of the same respective dates. The Company receives interest income on the invested collateral, which is included in net investment income.

### Other Invested Assets

Other invested assets are comprised of investments accounted for in accordance with the equity method of accounting, namely fund of funds and limited partnership interests, as well as convertible securities, which are carried at fair value.

The other invested assets activities for the years ended December 31, were as follows:

	<b>2019</b>	<b>2018</b>	<b>2017</b>
Purchases	\$ 147,920	\$ 132,317	\$ 53,389
Proceeds from sales	72,980	82,624	73,953
Net recognized gains	16,191	954	5,687

Net investment (loss) income for the years ended December 31 consists of the following:

	<b>2019</b>	<b>2018</b>	<b>2017</b>
Interest and dividend income	\$ 154,332	\$ 135,918	\$ 127,248
Net realized investment gains (losses)	74,708	(45,603)	44,365
Net realized foreign currency (losses)	(5,095)	(3,653)	(4,327)
Net unrealized investment gains (losses)	17,716	(7,266)	1,763
Net unrealized (losses) gains on foreign currency forward contracts	(1,018)	546	-
Total investment income	240,643	79,942	169,049
Investment expenses	(21,662)	(21,869)	(21,114)
Net investment income	\$ 218,981	\$ 58,073	\$ 147,935



# Associated Electric & Gas Insurance Services Limited

## Notes to the Consolidated Financial Statements (Expressed in thousands of U.S. dollars)

### 4. Fair Value Measurements

The following tables present information about assets and liabilities carried at fair value:

	December 31, 2019				
	Level 1	Level 2	Level 3	Investments Valued at NAV (*)	Total
<b>Assets:</b>					
Investments:					
Debt securities					
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$ -	\$ 241,106	\$ -	\$ -	\$ 241,106
Debt securities issued by foreign governments	-	290,172	-	-	290,172
U.S. corporate debt securities	-	753,771	-	-	753,771
Foreign corporate debt securities	-	174,782	-	-	174,782
Agency MBS	-	244,345	-	-	244,345
Non-Agency MBS and ABS	-	192,343	-	-	192,343
Syndicated bank loans/Direct lending	-	224,202	16,065	-	240,267
Total AFS investments	-	2,120,721	16,065	-	2,136,786
Equity Securities:					
Equity securities/REITs	142	-	-	205,970	206,112
Mutual fund bonds	-	266,217	-	-	266,217
Total equity securities	142	266,217	-	205,970	472,329
Cash equivalents including money market funds and short-term debt securities (***)					
	12,496	232,031	-	-	244,527
Total invested assets (**)	\$ 12,638	\$ 2,618,969	\$ 16,065	\$ 205,970	\$ 2,853,642
<b>Liabilities:</b>					
Fair value of insurance and reinsurance contracts					
	-	-	532,628	-	532,628
Total liabilities	\$ -	\$ -	\$ 532,628	\$ -	\$ 532,628

(\*) The Company adopted ASU 2015-07 in 2016 which allowed the exclusion of certain investments valued using Net Asset Value ("NAV") from the Fair Value Measurement tables. Investments valued using NAV as a practical expedient are listed in a separate column.

(\*\*) Excludes operating cash.

(\*\*\*) Cash and cash equivalents with a maturity of less than three months from purchase date are carried at amortized cost in the table above which approximates fair value.

Investments in the Fair Value Measurement table above exclude HTM securities and mortgage loans as these are carried at cost/amortized cost. Also, excluded are other invested assets which are comprised of investments accounted for in accordance with the equity method of accounting, namely fund of fund and limited partnership interests as well as convertible securities, which are carried at fair value. Convertible securities utilize the same valuation techniques as corporate debt securities, and therefore would be classified as a Level 2 security.

# Associated Electric & Gas Insurance Services Limited

## Notes to the Consolidated Financial Statements (Expressed in thousands of U.S. dollars)

	December 31, 2018				Total
	Level 1	Level 2	Level 3	Investments Valued at NAV (*)	
<b>Assets:</b>					
Investments:					
Debt securities					
U.S. Treasury securities and obligations of U.S. government corporations and agencies	\$ -	\$ 188,835	\$ -	\$ -	\$ 188,835
Debt securities issued by foreign governments	-	250,690	-	-	250,690
U.S. corporate debt securities	-	543,243	-	-	543,243
Foreign corporate debt securities	-	189,179	-	-	189,179
Agency MBS	-	330,443	-	-	330,443
Non-Agency MBS and ABS	-	115,678	-	-	115,678
Syndicated bank loans/Direct lending	-	269,652	22,256	-	291,908
Total AFS investments	-	1,887,720	22,256	-	1,909,976
Equity Securities:					
Equity securities/REITs	159,891	-	-	185,685	345,576
Mutual funds:					
Equity	-	119,243	-	-	119,243
Bonds	-	158,726	-	-	158,726
Total mutual funds	-	277,969	-	-	277,969
Total equity securities	159,891	277,969	-	185,685	623,545
Cash equivalents including money market funds and short-term debt securities (***)					
	17,481	159,237	-	-	176,718
Total invested assets (**)	\$ 177,372	\$ 2,324,926	\$ 22,256	\$ 185,685	\$ 2,710,239
<b>Liabilities:</b>					
Fair value of insurance and reinsurance contracts					
	-	-	472,057	-	472,057
Total liabilities	\$ -	\$ -	\$ 472,057	\$ -	\$ 472,057

(\*) The Company adopted ASU 2015-07 in 2016 which allowed the exclusion of certain investments valued using NAV from the Fair Value Measurement tables. Investments valued using NAV as a practical expedient are listed in a separate column.

(\*\*) Excludes operating cash.

(\*\*\*) Cash and cash equivalents with a maturity of less than three months from purchase date are carried at amortized cost in the table above which approximates fair value.

Investments in the Fair Value Measurement table above exclude HTM securities and mortgage loans as these are carried at cost/amortized cost. Also, excluded are other invested assets which are comprised of investments accounted for in accordance with the equity method of accounting, namely fund of fund and limited partnership interests as well as convertible securities, which are carried at fair value. Convertible securities utilize the same valuation techniques as corporate debt securities, and therefore would be classified as a Level 2 security.

# Associated Electric & Gas Insurance Services Limited

## Notes to the Consolidated Financial Statements (Expressed in thousands of U.S. dollars)

### Transfers of Assets and Liabilities between Fair Value Levels

The Company's policy is to transfer assets and liabilities from Level 1 to Level 2 and from Level 2 to Level 1 at their fair values at the end of each reporting period, consistent with the date of the determination of fair value. Investments are transferred from Level 1 to Level 2 when they are no longer transacted with sufficient frequency and volume to indicate an active market. Conversely, assets are transferred from Level 2 to Level 1 when transaction volume and frequency are indicative of an active market. The Company had no transfers between Levels 1 and 2 during the years ended December 31, 2019 and 2018.

The Company's policy is to transfer assets and liabilities into and out of Level 3 at their fair values at the end of each reporting period, consistent with the date of the determination of fair value.

The following tables present additional information about Level 3 assets and liabilities measured at fair value on a recurring basis at December 31:

	Insurance and Reinsurance Contracts			Direct Lending Investments		
	2019	2018	2017	2019	2018	2017
Balance, January 1	\$ (472,057)	\$ (460,399)	\$ (423,528)	\$ 22,256	\$ 31,612	\$ 35,176
Total (losses) gains realized/unrealized included in earnings	(59,873)	(1,630)	(31,284)	(185)	(257)	147
Issuances, purchases, and settlements:						
Issuances	(41,467)	(37,475)	(37,965)	-	-	-
Purchases	15,966	8,852	10,540	-	-	7,470
Settlements	24,803	18,595	21,838	(6,006)	(9,099)	(11,181)
Balance, December 31	<u>\$ (532,628)</u>	<u>\$ (472,057)</u>	<u>\$ (460,399)</u>	<u>\$ 16,065</u>	<u>\$ 22,256</u>	<u>\$ 31,612</u>
Changes in unrealized (losses) gains included in earnings related to obligations still held at reporting date	<u>\$ (59,873)</u>	<u>\$ (1,630)</u>	<u>\$ (31,284)</u>	<u>\$ (185)</u>	<u>\$ (257)</u>	<u>\$ 147</u>

# Associated Electric & Gas Insurance Services Limited

## Notes to the Consolidated Financial Statements (Expressed in thousands of U.S. dollars)

The table below presents information about the significant unobservable inputs used for recurring fair value measurements for insurance and reinsurance contracts:

### Quantitative Information for Level 3 Fair Value Measurements

Fair Value at December 31, 2019	Valuation Technique	Unobservable Input	Selected Estimate
\$ 532,628	Risk-adjusted discounted cash flows	Nominal net value of contracts	\$ 669,853
		Effective average discount rate <sup>(*)</sup>	72.97 %
		Risk margin <sup>(**)</sup>	7.87 %
Fair Value at December 31, 2018	Valuation Technique	Unobservable Input	Selected Estimate
\$ 472,057	Risk-adjusted discounted cash flows	Nominal net value of contracts	\$ 666,486
		Effective average discount rate <sup>(*)</sup>	63.80 %
		Risk margin <sup>(**)</sup>	9.15 %

(\*) *The effective average discount rate reflects the ratio of discounted future obligations over undiscounted payment patterns until final settlement. A decrease in interest rates increases both the effective average discount rate and the fair value of insurance and reinsurance contracts, with a corresponding reduction in net income. Should interest rates rise, both the discount rate and the fair value of the insurance and reinsurance contracts would decline with a corresponding increase to net income.*

(\*\*) *Risk reserve margin is expressed as a percentage of discounted loss liabilities and reflects the risk associated with the timing and amount of future loss payments.*

The Company's insurance and reinsurance contracts do not have observable market prices. The fair value of insurance and reinsurance contracts represents the Company's estimate of the cost to completely transfer its obligations and related reinsurance assets to another party of comparable creditworthiness.

The fair value of insurance and reinsurance contracts is based on the present value of expected future cash flows and a risk margin that would be payable to transfer the obligation to a third party. Expected future cash flows are comprised primarily of estimated payments to be made by the Company under the insurance contracts net of anticipated future recoveries under the related reinsurance contracts. The Company estimates future cash flows based on expected loss and loss expense payments estimated using accepted actuarial techniques, the timing of related future cash receipts or payments from these contracts and risk-free discount rates. A risk margin is calculated for potential deviations in the amount and timing of those estimated cash flows given the credit rating of the Company as well as additional return on capital a purchaser would require. These estimates are not observable in any marketplace, and actual future cash flows or other inputs could differ materially from these estimates.

The Company also holds an investment in a direct lending limited partnership, managed by a general partner. This investment is consolidated in the Company's financial statements, as it meets the VIE criteria for consolidation. The underlying investments in the partnership are classified as Level 3. The investments are comprised of various types of instruments, such as senior secured term loans, senior floating rate debt, and syndicated bank loans. The Company reviews the leveling techniques applied by the partnership to its investments, but relies on the partnership's specific pricing models, internal assumptions and the weighting of the best available pricing inputs. Standard pricing inputs for the securities held by the limited partnership include, but are not limited to, the financial health of the issuer, place in the capital structure, value of other issuer debt; credit, industry, and market risk and events; interest rates, spreads and yield curves; terms and conditions including a take-out premium; and comparable market transactions. Pricing inputs and weightings may require a subjective determination to arrive at an accurate valuation; therefore valuations do not necessarily represent the amounts that may eventually be realized from sales or other dispositions of investments.

# Associated Electric & Gas Insurance Services Limited

## Notes to the Consolidated Financial Statements (Expressed in thousands of U.S. dollars)

### 5. Mortgage Loans

The Company's mortgage loan portfolio consists of both residential and commercial loans. The loans are pro-rata participations in loans originated by a third party, and can be either fixed or floating rate loans.

Mortgage loans at December 31, are summarized as follows:

	2019			2018		
	Carrying Value*	Fair Value	% of Total	Carrying Value*	Fair Value	% of Total
Mortgage Loans:						
Commercial	\$ 122,443	\$ 123,655	61.7 %	\$ 117,348	\$ 117,802	68.0 %
Residential	76,496	77,773	38.5 %	55,577	55,831	32.2 %
Subtotal	198,939	201,428	100.2 %	172,925	173,633	100.2 %
Valuation allowances	(457)	-	(0.2)%	(349)	-	(0.2)%
Total, net	\$ 198,482	\$ 201,428	100.0 %	\$ 172,576	\$ 173,633	100.0 %

\*Carrying value before valuation allowance includes unearned loan commitment fees as of December 31, 2019 and 2018 of \$497 and \$691, respectively.

Purchases of mortgage loans for the year ended December 31, 2019 were \$53,846. Purchases of mortgage loans for the year ended December 31, 2018 were \$55,989 which included \$44,989 of 2018 purchases and \$11,000 from the settlement of a pending loan from 2017. The investment in mortgage loans are classified as Level 3 investments, as determined based on the Company's fair value measurement framework. The Company reviews various loan performance metrics and considers the originators' pricing techniques and valuation criteria.

The changes in the valuation allowance, by portfolio segment, were as follows:

	Commercial	Residential	Total
Balance at January 1, 2018	\$ 157	\$ 181	\$ 338
Provision 2018	70	(59)	11
Balance at December 31, 2018	227	122	349
Provision 2019	117	(9)	108
Balance at December 31, 2019	\$ 344	\$ 113	\$ 457

#### Valuation Allowance Methodology

Mortgage loans are considered impaired when it is probable, based upon available information that the Company will not collect amounts due under the loan agreement. In the event that a loan becomes uncollectible, the Company will adjust its established valuation allowance. The determination of the amount of the Company's valuation allowance is based upon known and inherent risks related to each loan. The allowance is determined based on several factors, including historical defaults, severity of losses, and anticipated losses for loans having similar risk characteristics. Risk factors such as geographic concentration, changes in economic climate and recovery experience are all considered when determining or increasing the Company's valuation allowance. These evaluations and assessments need to be revisited as conditions change and as new information becomes available.

The Company uses a common evaluation framework for its loans to establish a non-specific valuation allowance. For each loan the Company invests in, a related allowance is established at loan origination.

# Associated Electric & Gas Insurance Services Limited

## Notes to the Consolidated Financial Statements (Expressed in thousands of U.S. dollars)

The amount of the allowance is based on the type of loan and the associated risk profile, which is determined based on factors noted above. Loans having similar risk attributes are grouped and evaluated both individually, by loan, and collectively by loan portfolio. All commercial and residential loans are monitored on an ongoing basis and non-performing loans receive additional scrutiny.

Loans with similar risk elements are collectively valued for impairment. In order to ensure that the valuation allowance is sufficient to cover impairments the Company monitors both performing and non-performing loans. Non-performing loans are those loans that are 60 days or more past due or non-accruing. These loans are closely monitored as non-performing loans present the greatest risk of experiencing a credit loss. The Company also relies on the debt service coverage ratio, which compares the properties operating income to amounts needed to service the loan's principal and interest. The lower the debt service coverage ratio, the higher the risk the loan will experience a credit loss. The loan-to-value ratio of the real estate portfolio is also closely monitored, as loan-to-value ratios compare the unpaid principal balance of the loan to the fair value of the loan's underlying collateral. The higher the loan-to-value ratio, the higher the risk of experiencing credit loss. All of the above elements are taken into consideration when establishing or evaluating the portfolio's valuation allowance.

### ***Credit Quality of Mortgage Loans***

All loans in the Company's mortgage loan portfolio were performing at December 31, 2019 and 2018. There is no indication of any loan's credit deteriorating, as evidenced by the loan portfolios' carrying value being in close approximation to the Company's fair value.

The credit quality of mortgage loans as of December 31, was as follows:

	Cost			Total Estimated Fair Value	% of Total
	Debt Service Coverage Ratio > 1.2x				
	Commercial	Residential	Total		
<b>December 31, 2019</b>					
Loan-to-value ratios:					
Less than 65%	\$ 58,943	\$ 40,083	\$ 99,026	\$ 101,019	50.2%
65% to 75%	63,832	36,578	100,410	100,409	49.8%
Total	\$ 122,775	\$ 76,661	\$ 199,436	\$ 201,428	100.0%

	Cost			Total Estimated Fair Value	% of Total
	Debt Service Coverage Ratio > 1.2x				
	Commercial	Residential	Total		
<b>December 31, 2018</b>					
Loan-to-value ratios:					
Less than 65%	\$ 54,580	\$ 20,200	\$ 74,780	\$ 74,797	43.1%
65% to 75%	63,296	35,540	98,836	98,836	56.9%
Total	\$ 117,876	\$ 55,740	\$ 173,616	\$ 173,633	100.0%

# Associated Electric & Gas Insurance Services Limited

## Notes to the Consolidated Financial Statements (Expressed in thousands of U.S. dollars)

### 6. Variable Interest Entities

The Company, through its subsidiary, AEGIS London Holding, holds investments in two entities that are variable interest entities ("VIEs"). Collectively, the VIEs provide 7% of the underwriting capacity of AEGIS London and maintain whole account quota share reinsurance contracts with third parties. The Company holds the power to direct the most significant activities of the entities, as well as an economic interest in the entities and, as such, is the primary beneficiary. Therefore, these VIEs are included in the consolidated Company's financial statements.

The Company invests in a limited partnership direct lending investment, and based on its contractual commitment, its economic interest in the partnership and its span of control, the investment is treated as a VIE and included in the consolidated Company's financial statements.

The determination of a VIE's primary beneficiary requires an evaluation of the Company's obligations in relation to other parties' relationship or involvement with the entity, as well as a determination of the allocation of expected residual returns or expected losses to each party involved in the transaction. While a qualitative approach is applied, for VIEs that are investment companies, the primary beneficiary is considered to be the party absorbing a majority of the VIE's expected losses or receiving a majority of the VIE's expected returns.

The table below reflects the carrying amount and balance sheet caption in which the assets and liabilities of the consolidated VIE's reported as of December 31:

	Reinsurance Contracts		Direct Lending	
	2019	2018	2019	2018
Cash and cash equivalents	\$ 240	\$ 1	\$ -	\$ 1
Investments	-	-	16,065	22,256
Accrued interest	-	-	57	96
Prepaid reinsurance premiums	24,937	21,358	-	-
Current income taxes receivable	-	-	(1,972)	(1,629)
Net deferred tax asset	-	-	495	245
<b>Total Assets of Consolidated VIEs</b>	<b>\$ 25,177</b>	<b>\$ 21,359</b>	<b>\$ 14,645</b>	<b>\$ 20,969</b>
Due to reinsurers	\$ 24,272	\$ 19,573	\$ -	\$ -
Accrued expenses and other liabilities	-	-	142	90
<b>Total Liabilities of Consolidated VIEs</b>	<b>\$ 24,272</b>	<b>\$ 19,573</b>	<b>\$ 142</b>	<b>\$ 90</b>

# Associated Electric & Gas Insurance Services Limited

## Notes to the Consolidated Financial Statements (Expressed in thousands of U.S. dollars)

### 7. Premiums

Written and earned premiums are comprised of the following:

	Years Ended December 31,		
	2019	2018	2017
Written Premiums:			
Direct	\$ 1,802,835	\$ 1,552,367	\$ 1,335,006
Assumed	12,898	14,778	9,699
Subtotal	1,815,733	1,567,145	1,344,705
Ceded	658,945	539,124	464,058
Net	\$ 1,156,788	\$ 1,028,021	\$ 880,647
Earned Premiums:			
Direct	\$ 1,645,195	\$ 1,452,141	\$ 1,282,604
Assumed	14,693	12,654	8,488
Subtotal	1,659,888	1,464,795	1,291,092
Ceded	588,105	503,767	438,961
Net	\$ 1,071,783	\$ 961,028	\$ 852,131

### 8. Reserve for Losses, Loss Expenses, and Reinsurance

The Company establishes reserves based on estimated unpaid ultimate liabilities for losses and loss expenses. Reserves include both estimates of reported claims and incurred but not reported ("IBNR") claims, and include estimates of expenses associated with the processing and settlement of the related claims. Reserves are recorded in reserve for losses and loss expenses in the consolidated balance sheets. While the Company believes that its reserves for loss and loss expenses at December 31, 2019 were adequate, new information or trends may lead to future developments which may result in the need for significantly greater or lesser reserves than were provided. Any such future revisions would result in changes in estimates of losses or reinsurance and would be reflected in the Company's results of operations in the period in which the estimates are adjusted.



# Associated Electric & Gas Insurance Services Limited

## Notes to the Consolidated Financial Statements (Expressed in thousands of U.S. dollars)

Activity in the reserve for losses and loss expenses is summarized as follows:

	Years Ended December 31,		
	2019	2018	2017
Reserve for losses and loss expenses at January 1	\$3,659,832	\$3,306,617	\$3,068,261
Unpaid losses and loss expenses recoverable	(1,559,026)	(1,257,189)	(1,012,109)
Net reserve for losses and loss expenses at January 1	2,100,806	2,049,428	2,056,152
Net incurred losses and loss expenses relating to losses occurring in:			
Current year	724,751	604,995	692,999
Prior years	18,957	(23,952)	(136,212)
Subtotal	743,708	581,043	556,787
Foreign exchange losses	9,450	13,684	11,118
Total net incurred losses and loss expenses	753,158	594,727	567,905
Net paid losses and loss expenses relating to losses occurring in:			
Current year	116,120	94,621	106,555
Prior years	570,286	448,728	468,074
Total net paid losses and loss expenses	686,406	543,349	574,629
Net reserve for losses and loss expenses at December 31	2,167,558	2,100,806	2,049,428
Unpaid losses and loss expenses recoverable	1,860,929	1,559,026	1,257,189
Reserve for losses and loss expenses at December 31	\$ 4,028,487	\$3,659,832	\$ 3,306,617

For purposes of analysis and reporting, the Company segments its reserve for losses and loss expenses, and related incurred losses, into segments that generally align with insurance products or lines of business that have similar characteristics, trends and development patterns. The following is a description of each reserve reporting segment:

### ***U.S.—Excess Liability***

Excess liability policies cover exposures which include, but are not limited to, bodily injury, property damage and personal injury arising out of certain hazards. Included within Excess Liability are AEGIS' pollution exposures. The excess liability product is predominately written on a claims first-made basis. The coverage of these policies is triggered only if a claim is made against the insured or a notice of circumstances is provided to the Company within the coverage period.

### ***U.S.—Property***

Property policies provide all-risk property coverage for direct physical loss or damage to real and personal property of operational facilities, and under builder's risk policy for the construction and testing of new facilities and upgrading existing facilities.

### ***U.S.—Directors & Officers ("D&O")***

D&O coverage covers liabilities of the Company including personal liabilities for the directors and officers.

# Associated Electric & Gas Insurance Services Limited

## Notes to the Consolidated Financial Statements (Expressed in thousands of U.S. dollars)

### *Syndicate*

Syndicate covers a wide range of onshore and offshore energy risks, including a number of other classes, traditionally written in the Lloyd's syndicate market. The insurance portfolio is comprised of two main business lines: property and casualty, which includes the marine energy and specialty lines. The Syndicate has diverse insurance portfolios under its property and casualty lines of business, which consists of several classes of underwritten risks.

*Syndicate—Property* The main risks underwritten include property facilities, property, open market, energy property, marine short hull and war, marine short tail and cargo, property utility, crop and reinsurance.

*Syndicate—Casualty* The main risks underwritten include U.S. casualty and international casualty, niche errors and omissions, marine casualty and energy casualty.

### *Other*

The Company has assumed business from various third parties and provides coverage on various risk exposures which include cyber risk, railroad protection liability, fiduciary and employee beneficiary liability and other specialty lines.

### **Prior Year Loss Development**

For the years ended December 2019, 2018 and 2017, changes in actuarial estimates of insured events in the prior years have resulted in a net increase in 2019 of \$18,957 and a net decrease to the reserve for losses and loss expenses of \$23,952 and \$136,212 in 2018 and 2017, respectively.

The impact of prior accident year development on loss reserves for each of the reserve reporting segments is presented below:

	Years Ended December 31,		
	2019	2018	2017
US - Excess Liability	\$ 32,233	\$ (12,896)	\$ (82,170)
US - Property	(9,061)	(22,794)	(11,599)
US - Directors & Officers	(742)	4,215	10,860
Syndicate - Property	2,081	(1,353)	(20,619)
Syndicate - Casualty	(6,570)	(10,985)	(28,100)
Other	1,016	19,861	(4,584)
Total unfavorable (favorable) prior year development	\$ 18,957	\$ (23,952)	\$ (136,212)

# Associated Electric & Gas Insurance Services Limited

## Notes to the Consolidated Financial Statements (Expressed in thousands of U.S. dollars)

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The following describes the primary factors behind prior year reserve development for the years ended December 31, 2019, 2018 and 2017.

### 2019

U.S.—Excess Liability	Unfavorable development due to increased large claim activity.
U.S.—Property	Gross ultimate loss reductions have been driven by lower than expected attritional losses and an absence of catastrophe and shock losses.
U.S.—D&O	Favorable development due to lower incurred loss experience.
Syndicate—Property	Unfavorable development due to strengthening in the Property line driven by an increase in reserving for runoff classes including Aviation.
Syndicate—Casualty	Favorable development due to lower paid and incurred loss experience, as well as loss reductions, particularly for the Marine Casualty line of business.

### 2018

U.S.—Excess Liability	Favorable development in the general liability line of business, partially offset by unfavorable development from pollution exposures.
U.S.—Property	Favorable development on attritional losses as well as decreases on previously established provisions related to Hurricanes Harvey, Irma and Maria.
U.S.—D&O	Unfavorable development due to increased large claim activity.
Syndicate—Property	Favorable development from prior year loss experience related to prior year catastrophes, partially offset by multiple Marine Short Tail Hull and War losses.
Syndicate—Casualty	Favorable development due to lower paid and incurred loss experience particularly for the Marine Casualty line of business.

### 2017

U.S.—Excess Liability	Favorable development in the general liability line of business, partially offset by unfavorable development from pollution exposures.
U.S.—Property	Favorable development on attritional losses.
U.S.—D&O	Unfavorable development due to increased large claim activity.
Syndicate—Property	Favorable development due to overall paid and incurred loss experience across property and specialty lines of business, in particular, energy property, cyber and terrorism.
Syndicate—Casualty	Favorable development due to overall paid and incurred loss experience in the U.S. casualty and international lines of business.

# Associated Electric & Gas Insurance Services Limited

## Notes to the Consolidated Financial Statements (Expressed in thousands of U.S. dollars)

### **Short Duration**

ASU 2015-09, *Disclosures about Short-Duration Contracts* (Topic 944), requires the following to be presented in the consolidated financial statements: (I) reconciliation from the claim development tables to the balance sheet liability, (II) methodologies and judgments in estimating claims, and (III) the timing and frequency of claims.

### **(I) Reconciliation of Reserves by Segment to Balance Sheet Liability—Reserve for losses and loss expenses**

The table below presents a reconciliation of the loss development tables to the liability for reserve for losses and loss expenses as of December 31:

	<b>2019</b>
<b><i>Net reserve for losses and loss expenses</i></b>	
Presented in the loss development tables:	
US - Excess Liability	\$ 1,155,036
US - Property	78,547
US - Directors & Officers	126,379
Syndicate - Property 2012-2019	257,053
Syndicate - Casualty 2012-2019	345,163
Syndicate - 2011 and prior	30,147
Other	129,149
Net reserve for losses and loss expenses	\$ 2,121,474
<b><i>Ceded reserve for losses and loss expenses:</i></b>	
US - Excess Liability	\$ 1,087,302
US - Property	296,531
US - Directors & Officers	161,329
Syndicate - Property 2012-2019	81,381
Syndicate - Casualty 2012-2019	209,934
Syndicate - 2011 and prior	14,276
Other	10,176
Ceded reserve for losses and loss expenses	1,860,929
Unallocated loss adjustment expenses	46,084
Reserve for losses and loss expenses	\$ 4,028,487

Unallocated loss adjustment expenses and the reserve segment Other are excluded from the loss development tables in section (III). "Other" is comprised of the following:

- Business assumed from third parties.
- Minor lines of business mostly consisting of Cyber and Generation Outage products.
- Run-off lines of business.
- Bad debt for reinsurance recoverable.
- Other adjustments.

# Associated Electric & Gas Insurance Services Limited

## Notes to the Consolidated Financial Statements (Expressed in thousands of U.S. dollars)

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### (II) Description of Reserving Methodology

The Company's reserving process involves the collaboration of our underwriting, claims, actuarial, and finance divisions, and it culminates with the approval of a single point best estimate by senior management. In selecting this best estimate, management considers actuarial estimates and applies informed judgment regarding qualitative factors that may not be fully captured in these actuarial estimates. Such factors include, but are not limited to:

- The timing of the emergence of claims
- Volume and complexity of claims
- Social and judicial trends
- Potential severity of individual claims

The following factors are also taken into consideration when establishing management's best estimate: exposure trends, rate adequacy on new and renewal business, ceded reinsurance costs, changes in claims emergence, and our underwriters' view of terms and conditions in the insurance and reinsurance market environment. While all of the above factors are considered, no specific provisions for qualitative factors are established. The Company has actuarial staff who analyze loss reserves (including loss expenses), and regularly project estimates of ultimate losses and the corresponding indications of the required IBNR reserves. The reserving approach is a comprehensive ground-up process using data at a detailed level which reflects the specific lines and sublines. The data presented in this disclosure was prepared on a more aggregated basis and with a focus on changes in incurred loss estimates over time as well as associated cash flows. On no less than an annual basis, the Company uses an independent actuarial firm to provide an actuarial opinion on the reasonableness of our loss reserves for each of our business subsidiaries and statutory reporting entities.

#### *Standard Actuarial Reserving Methods*

The Company's reserving process begins with the collection and analysis of paid and incurred claim data for each of the lines of business. This line of business data is disaggregated by reserving class and is further disaggregated by policy year (i.e. the year in which the contract generated premium and losses inception). Our reserving classes are selected to ensure that the underlying contracts have homogeneous loss development characteristics, while remaining large enough to make the estimation of trends credible. We review our reserving classes on a regular basis and adjust them over time as our business evolves. This data serves as a key input to many of the methods employed by our actuaries.

#### *Actuarial Analysis*

Multiple actuarial methods are available to estimate ultimate losses. Each method has its own assumptions and its own advantages and disadvantages, with no single estimation method being better than the others in all situations, and no one set of assumption variables being meaningful for all reserving classes. The relative strengths and weaknesses of the particular estimation methods when applied to a particular group of claims can also change over time.

The following is a brief description of the reserve estimation methods commonly employed by our actuaries and a discussion of their particular strengths and weaknesses:

*Expected Loss and Expected Loss Ratio Method ("ELR Method")*: Both the Expected Loss and Expected Loss Ratio Method produce an estimate of ultimate losses for a policy year. In the Expected Loss Method, the initial expected losses for each reserving class and policy year are a "proxy" or ex-ante estimate of actual ultimate losses by policy year. The expected losses are based on adequate premiums for the policies that we write and recognize the varying attachment points, limits, changing exposure and term of the underlying policies. This method is a direct calculation of exposure to loss and is reliant on detailed loss information. A similar method, the ELR Method, estimates ultimate losses by applying

# Associated Electric & Gas Insurance Services Limited

## Notes to the Consolidated Financial Statements (Expressed in thousands of U.S. dollars)

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an expected loss ratio to earned premiums for an accident year, or expected loss ratio to written premiums for policy year. Generally, expected loss ratios are based on one or more of (a) an analysis of historical loss experience to date, (b) pricing information and (c) industry data, adjusted as appropriate, to reflect changes in rates and terms and conditions. This method is insensitive to actual incurred losses for the accident year or underwriting year in question and is, therefore, often useful in the early stages of development when very few losses have been incurred. Conversely, the lack of sensitivity to incurred/paid losses for the policy year in question means that this method is usually inappropriate in later stages of development.

*Loss Development Method* (also referred to as the “*Chain Ladder Method*” or “*Link Ratio Method*”): The paid and incurred development factor methods analyze historical loss experience to determine a paid and an incurred development pattern that is representative of the underlying experience. The development pattern reflects growth in loss experience from inception date to maturity date, e.g. 6-18 months, 18-30, 30-42, etc. The growth factors are sometimes referred to as age-to-age factors. Selected age-to-age factors are then accumulated multiplicatively to produce age-to-ultimate factors which measure the growth from the current maturity to ultimate maturity. The selected age-to-ultimate factors are applied to actual paid or incurred dollars for each policy year as of the evaluation date to produce ultimate losses by policy year. This method assumes that losses for each policy year at a particular development stage follow a relatively similar pattern. The percentages incurred and paid are established for each development stage (e.g. 6 months, 18 months, etc.) after examining a number of different averages of actual age-to-age factors in determining selected age-to-age factors. The standard averages reviewed vary and include simple average and dollar volume-weighted averages using all years as well as only 1 through 5 years or 10 to 15 years. Age-to-age factors may also be excluded from the averages described above when actual experience may be producing outlier results which could skew the results, unless modified or excluded. Prior to selecting the final age-to-age factors, standard curve fitting techniques are applied to the initial selections of age-to-age factors. This allows for potentially more stable factors from age-to-age, particularly for durations where the amount of data upon which the curve fit is based is sparse, as well as for extrapolation of development beyond the oldest maturity age. The final selections of age-to-age factors are based on actuarial judgment as to which loss development pattern best matches their expectation for future development. Ultimate losses are then estimated by multiplying the actual incurred or paid losses by the reciprocal of the established incurred or paid percentage. The strengths of this method are that it reacts to loss emergence/payments and that it makes full use of historical claim emergence or payment experience. However, this method has weaknesses when the underlying assumption of stable loss development/payment patterns is not valid. This could be the consequence of changes in business mix, claim inflation trends or claim reporting practices and/or the presence of large claims, among other things. Furthermore, this method tends to produce volatile estimates of ultimate losses where there is volatility in the underlying incurred or paid patterns. In particular, where the expected percentage of incurred or paid losses is low, small deviations between actual and expected claims can lead to very volatile estimates of ultimate losses. As a result, this method is often unsuitable at early development stages by policy year.

*Bornhuetter-Ferguson Method (“BF Method”)*: This method can be seen as a combination of the ELR and Loss Development Methods, under which the Loss Development Method is given progressively more weight as a policy year matures. The main advantage of the BF Method is that it provides a more stable estimate of ultimate losses than the Loss Development Method at earlier stages of development, while remaining more sensitive to emerging loss development than the ELR Method. In addition, the BF Method allows for the incorporation of expert opinion through the use of expected losses, whereas the Loss Development Method does not incorporate such information. The initial estimate of ultimate losses is based on exposure proxy information by policy year produced by management, or a selected loss ratio. The expected percentage of losses unpaid (or unreported) is based on the paid or incurred loss development patterns selected in the Development Factor Methods, as described above.

*Cape Cod Method*: The Cape Cod method is a variant of the BF Method. The Cape Cod method applies a formulaic process to determining the initial estimate of ultimate losses based on exposures and claims experience to date, rather than requiring user input of the initial estimate.

# Associated Electric & Gas Insurance Services Limited

## Notes to the Consolidated Financial Statements (Expressed in thousands of U.S. dollars)

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*Average Cost per Claim Method ("Frequency/Severity Method"):* This method develops separate estimates of the expected ultimate claim counts (frequency component) and the expected ultimate average claim cost (severity component). The multiplication of the two components yields the indicated ultimate loss for each policy year. Both frequency and severity components utilize the approach as described in the Loss Development Factor Methods above to determine their ultimate amounts. Ultimate claim counts are based on a review of closed claim count development over time, while ultimate average costs are based on a review of average severity development over time.

As part of our quarterly and semi-annual loss reserve review processes, the selection of ultimate losses by sub-segment (line of business and reserving class) is based on a review of the results of the methods described above, together with management's judgment, where appropriate, as to the most likely outcome. For each policy year, weights that vary between 0% and 100% are applied to each method. The weighting is judgmental and may vary from year to year based on management's knowledge and judgment regarding changes in the mix of business or exposures and operational changes in claims handling. For the initial estimate of the current accident year, available claims data is typically insufficient to produce a reliable estimate of ultimate losses. As a result, our initial estimate for the current policy year is generally based on the ELR Method for longer-tail lines and BF Method for shorter-tail lines.

### *Reserving for Significant Catastrophic Events*

The Company cannot estimate losses from widespread catastrophic events, such as hurricanes and earthquakes, using the traditional actuarial methods described above. Rather, loss reserves for such events are estimated by management after a catastrophe occurs by completing an in-depth analysis of individual contracts which may potentially be impacted by the catastrophic event. This in-depth analysis may rely on several sources of information, including: (1) estimates of the size of insured industry losses from the catastrophic event and our corresponding market share; (2) a review of our portfolio of contracts performed to identify those contracts which may be exposed to the catastrophic event; (3) a review of modeled loss estimates based on information previously reported by insureds, including exposure data obtained during the underwriting process; (4) discussions of the impact of the event with our insureds; and (5) catastrophe bulletins published by various independent statistical reporting agencies. The Company generally utilizes a blend of these information sources to arrive at an aggregate estimate of the ultimate losses arising from the catastrophic event. In subsequent reporting periods, changes in paid and incurred losses in relation to each significant catastrophe are reviewed, and estimates of ultimate losses for each event are adjusted if there are developments that are different from prior expectations. Adjustments are recorded in the period in which they are identified.

There are additional risks affecting the ability to accurately estimate ultimate losses for catastrophic events. For example, estimation of loss reserves related to hurricanes and earthquakes can be affected by factors including, but not limited to, inability to access portions of impacted areas, infrastructure disruptions, the complexity of factors contributing to losses, legal and regulatory uncertainties, complexities involved in estimating business interruption losses, the impact of demand surge, fraud, and the limited nature of information available. For hurricanes, additional complex coverage factors may include determining whether damage was caused by flooding versus wind, evaluating general liability and pollution exposures, and mold damage. The timing of a catastrophe, near the end of a reporting period, can also affect the level of information available to estimate reserves for that reporting period.

### *Environmental-Related Claims*

Included in the reserve for losses and loss expenses are amounts held for losses relating to manufactured gas plant cleanup costs and losses related to exposure to asbestos. In estimating amounts to be provided, management considers various information, including the number of reported claims, the continually evolving legal environment in each jurisdiction and the trends in remediation

# Associated Electric & Gas Insurance Services Limited

## Notes to the Consolidated Financial Statements (Expressed in thousands of U.S. dollars)

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and medical costs. Uncertainties exist as to the extent of coverage, the existence of other potentially responsible parties, the likelihood of the Company being liable, and the share of the ultimate cost, if any, that the Company will bear.

### (III) Loss Development Tables

The loss development tables provided hereafter, present historical incurred and paid claims development by reserve reporting segment through December 31, 2019, net of reinsurance.

Each table follows a similar format and includes the following:

- An incurred loss triangle which includes reported and unreported but incurred claims.
- The incurred and paid triangles include allocated loss adjustment expense, but exclude any unallocated loss adjustment expense.
- All information presented in the triangles is net of reinsurance recoverable.
- IBNR reserves as of December 31, 2019 are shown to the right of the incurred loss table.
- Claims counts are cumulative and are reported to the right of the net paid loss tables. Excluded from claims counts are claims closed without payment.
- Net liabilities for loss and loss expenses for accident years prior to those presented in the triangles.

Prior to calendar year 2012, the Company did not track for the Syndicate business the Company's incurred claims and claims expenses and associated paid losses by accident year at the level of detail that is consistent with the current reserve reporting segments included in the triangles. It was not practical to obtain the required historical data needed for the Syndicate Property and Casualty triangles before 2012. As a result, the triangles for the Syndicate are eight year tables ranging from 2012 to 2019.

Supplementary information about average annual percentage payout of net incurred claims is presented for both U.S. and Syndicate lines of business.

Portions of the business written by the U.S. and Syndicate reserve reporting segments are denominated in foreign currencies. In order to keep a constant currency basis, the same foreign exchange rate was achieved by assuming constant foreign exchange rates for all periods presented in the triangles. Translation of prior period amounts use the same applicable foreign currency exchange rates as the current year-end rates.



# Associated Electric & Gas Insurance Services Limited

## Notes to the Consolidated Financial Statements (Expressed in thousands of U.S. dollars)

U.S. - Excess Liability (In \$000's except claim count)

Incurred Losses and Allocated Loss Adjustment Expenses, Net of Reinsurance  
Year Ended December 31,

	Unaudited									December 31, 2019	
	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Net IBNR
<b>Accident Year</b>											
2010	\$202,256	\$217,352	\$173,663	\$153,845	\$159,287	\$138,177	\$137,698	\$149,471	\$154,765	\$157,973	\$3,461
2011		225,302	203,643	162,268	179,264	173,739	175,245	186,408	180,462	187,271	6,782
2012			232,136	226,959	222,697	235,610	237,266	244,146	244,617	228,207	10,363
2013				261,869	225,547	237,711	237,180	222,328	212,910	204,985	8,160
2014					288,255	267,496	248,461	241,221	234,770	231,407	24,161
2015						290,683	281,842	224,200	186,862	198,939	42,059
2016							267,526	252,525	242,817	232,333	22,958
2017								297,572	320,260	302,203	37,130
2018									244,324	269,092	68,163
2019										266,175	176,292
Total										\$2,278,585	

Cumulative Paid Losses and Allocated Loss Adjustment Expenses, Net of Reinsurance

											Cumulative Number of Reported Claims
2010	\$397	\$30,801	\$76,713	\$93,709	\$115,494	\$118,158	\$118,049	\$128,373	\$145,132	\$148,478	135
2011		2,976	24,488	72,927	98,295	123,143	142,836	158,516	164,454	173,890	146
2012			157	39,572	79,632	107,992	138,308	174,178	179,526	193,139	144
2013				7,580	42,111	83,996	103,281	157,322	168,149	167,796	111
2014					613	32,973	49,103	113,178	143,633	152,573	129
2015						240	73,733	95,177	102,695	122,034	105
2016							260	39,646	83,876	174,838	96
2017								5,383	112,055	166,001	95
2018									3,601	123,953	68
2019										150	28
Total										\$1,422,852	
										299,303	
										\$1,155,036	

All outstanding liabilities before 2010 net of reinsurance  
Liabilities for losses and loss adjustment expenses, net of reinsurance

# Associated Electric & Gas Insurance Services Limited

## Notes to the Consolidated Financial Statements (Expressed in thousands of U.S. dollars)

U.S.—Property (In \$000's except claim count)

### Incurred Losses and Allocated Loss Adjustment Expenses, Net of Reinsurance Year Ended December 31,

Accident Year	Unaudited									December 31, 2019	Net IBNR
	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	
2010	\$ 71,526	\$ 79,594	\$ 72,498	\$ 72,459	\$ 71,359	\$ 68,697	\$ 65,522	\$ 66,890	\$ 64,552	\$ 64,550	\$ (1)
2011		116,955	113,990	118,044	112,505	111,974	111,283	110,856	110,828	110,896	-
2012			58,248	85,152	101,760	76,531	74,086	73,482	73,181	73,243	-
2013				41,011	30,566	29,252	27,900	27,390	27,385	27,390	3
2014					42,390	31,064	29,395	28,350	28,122	28,250	3
2015						30,027	24,675	20,390	18,803	18,490	131
2016							32,304	26,190	22,759	20,829	659
2017								36,721	21,001	18,516	639
2018									43,123	39,140	3,953
2019										47,765	18,470
Total										<u>\$ 449,069</u>	

### Cumulative Paid Losses and Allocated Loss Adjustment Expenses, Net of Reinsurance

										Cumulative Number of Reported Claims	
2010	\$ 12,254	\$ 29,388	\$ 44,678	\$ 57,084	\$ 57,930	\$ 54,980	\$ 55,254	\$ 55,345	\$ 64,282	\$ 64,282	137
2011		14,562	59,776	83,139	107,651	109,474	111,028	110,852	110,888	110,896	145
2012			13,509	37,181	49,225	64,652	73,081	73,260	73,244	73,244	128
2013				7,794	15,738	26,244	26,907	27,383	27,384	27,388	103
2014					5,627	12,043	24,318	27,419	27,898	28,181	105
2015						4,270	10,196	14,331	17,356	17,374	118
2016							4,446	13,665	18,168	19,029	120
2017								2,864	9,395	14,251	174
2018									2,914	11,471	170
2019										6,124	126
Total										<u>\$ 372,240</u>	

All outstanding liabilities before 2010 net of reinsurance  
Liabilities for losses and loss adjustment expenses, net of reinsurance

1,718  
\$ 78,547

# Associated Electric & Gas Insurance Services Limited

## Notes to the Consolidated Financial Statements (Expressed in thousands of U.S. dollars)

U.S.—D&O (In \$000's except claim count)

### Incurring Losses and Allocated Loss Adjustment Expenses, Net of Reinsurance Year Ended December 31,

Accident Year	Unaudited									December 31, 2019	Net IBNR
	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	
2010	\$ 54,867	\$ 50,313	\$ 51,862	\$ 69,332	\$ 58,366	\$ 57,074	\$ 56,212	\$ 51,036	\$ 51,049	\$ 51,046	\$ -
2011		39,118	34,449	14,390	11,231	9,271	8,337	6,458	6,468	6,457	-
2012			27,263	19,816	22,033	18,740	17,178	14,752	12,727	12,660	26
2013				28,592	31,914	28,226	26,234	25,212	17,222	19,812	136
2014					38,054	31,498	23,596	18,216	12,696	17,031	(1,457)
2015						27,541	37,515	70,467	77,389	74,886	(1,274)
2016							30,568	26,973	29,535	33,358	3,238
2017								40,148	51,948	48,454	6,503
2018									20,718	15,857	14,917
2019										29,265	27,795
Total										<u>\$ 308,826</u>	

### Cumulative Paid Losses and Allocated Loss Adjustment Expenses, Net of Reinsurance

											Cumulative Number of Reported Claims	
2010	\$ 75	\$ 4,048	\$ 4,715	\$ 5,299	\$ 41,092	\$ 41,141	\$ 46,595	\$ 51,043	\$ 51,046	\$ 51,046	\$ 51,046	31
2011		1,358	6,009	6,186	6,457	6,457	6,457	6,457	6,457	6,457	6,457	28
2012			24	79	3,055	10,110	10,112	10,112	10,115	10,429	10,429	11
2013				341	4,474	14,470	15,273	15,997	16,617	16,632	16,632	20
2014					1,062	3,185	5,477	6,330	6,968	8,865	8,865	15
2015						33	11,295	22,514	32,407	62,498	62,498	18
2016							1,549	11,031	14,078	14,083	14,083	20
2017								335	5,193	12,262	12,262	16
2018									60	129	129	19
2019										56	56	14
Total										<u>\$ 182,457</u>		

All outstanding liabilities before 2010, net of reinsurance  
Liabilities for losses and loss adjustment expenses, net of reinsurance

10  
\$ 126,379

### U.S. - Claims Duration

The following table provides supplementary unaudited information about the percentage payout of incurred losses and loss expenses, net of reinsurance as of December 31, 2019 for the U.S. reserve segments.

Age in years	Average Annual Percentage Payout of Incurred Claims by Age, Net of Reinsurance									
	Unaudited									
	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
Excess liability	1%	24%	18%	17%	15%	7%	3%	5%	8%	2%
Property	18%	32%	27%	14%	3%	0%	0%	0%	7%	0%
D&O	4%	19%	16%	12%	20%	3%	3%	4%	0%	0%

# Associated Electric & Gas Insurance Services Limited

## Notes to the Consolidated Financial Statements (Expressed in thousands of U.S. dollars)

Syndicate—Property and Casualty (\$000's except claim count)  
Incurred Losses and Allocated Loss Adjustment Expenses, Net of Reinsurance

Year Ended December 31,

**Property**

	Unaudited								December 31, 2019
Accident Year	2012	2013	2014	2015	2016	2017	2018	2019	Net IBNR
2012	\$162,311	\$141,484	\$138,114	\$136,005	\$137,489	\$136,458	\$136,175	\$135,971	\$ (171)
2013		165,411	138,384	140,395	139,341	139,280	138,953	138,355	(747)
2014			179,416	163,527	164,255	157,044	158,147	160,576	160
2015				160,929	131,136	133,519	132,433	130,603	774
2016					171,074	162,329	161,050	163,928	617
2017						204,038	185,578	194,914	3,292
2018							209,582	199,003	13,895
2019								238,892	93,172
Total								\$1,362,242	
									<b>Cumulative Number of Reported Claims</b>
<b>Cumulative Paid Losses and Allocated Loss Adjustment Expenses, Net of Reinsurance</b>									
2012	\$48,860	\$106,717	\$121,554	\$128,813	\$130,841	\$131,865	\$132,717	\$133,240	6,036
2013		56,389	108,021	126,538	133,225	136,045	136,984	137,842	6,218
2014			78,342	122,666	143,223	148,943	151,125	154,930	6,549
2015				53,218	97,773	112,944	119,729	123,984	7,238
2016					78,666	130,386	145,166	151,531	8,087
2017						78,084	142,688	167,901	9,065
2018							67,556	144,862	8,456
2019								90,899	5,321
Total								\$1,105,189	
									\$257,053
									Liabilities for losses and loss adjustment expenses, net of reinsurance (2012-2019)

# Associated Electric & Gas Insurance Services Limited

## Notes to the Consolidated Financial Statements (Expressed in thousands of U.S. dollars)

Year Ended December 31,

### Casualty

Accident Year	2012	2013	Unaudited					2018	2019	December 31, 2019
			2014	2015	2016	2017	Net IBNR			
2012	\$ 93,489	\$ 81,619	\$ 65,016	\$62,298	\$56,768	\$51,642	\$50,347	\$48,920	\$ (917)	
2013		72,038	69,339	62,282	59,958	53,929	52,061	47,148	2,735	
2014			89,160	83,926	76,019	71,491	69,330	64,476	4,713	
2015				82,123	88,991	77,988	73,137	71,887	4,948	
2016					69,888	71,289	63,153	62,302	17,828	
2017						91,945	93,804	87,304	35,896	
2018							105,571	103,537	61,002	
2019								117,235	95,472	
Total								\$602,809		
<b>Cumulative Paid Losses and Allocated Loss Adjustment Expenses, Net of Reinsurance</b>										
2012	\$ 6,982	\$ 16,104	\$ 25,582	\$ 33,514	\$36,254	\$38,570	\$41,831	\$43,122	1,923	
2013		1,932	6,377	18,240	23,137	28,265	32,881	36,590	2,804	
2014			7,920	13,260	28,881	36,670	47,315	51,365	2,783	
2015				9,883	18,076	27,782	37,280	42,516	2,798	
2016					3,615	11,802	20,150	28,467	3,199	
2017						9,312	16,664	27,405	3,258	
2018							5,737	20,315	3,043	
2019								7,866	1,922	
Total								\$257,646		
Liabilities for losses and loss adjustment expenses, net of reinsurance (2012-2019)									\$345,163	
All outstanding liabilities before 2012, net of reinsurance									30,147	
Liabilities for losses and loss adjustment expenses, net of reinsurance									\$632,363	

### Syndicate—Claims Duration

The following table provides supplementary unaudited information about the percentage payout of incurred losses and loss expenses, net of reinsurance as of December 31, 2019 for the Syndicate business.

Age in Years	Average Annual Percentage Payout of Incurred Claims by Age, Net of Reinsurance							
	Unaudited							
	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8
Property	41%	34%	12%	5%	2%	1%	1%	0%
Casualty	9%	12%	18%	13%	10%	7%	7%	3%

# Associated Electric & Gas Insurance Services Limited

## Notes to the Consolidated Financial Statements (Expressed in thousands of U.S. dollars)

### Reinsurance

The Company cedes a portion of its risk by utilizing various reinsurance contracts in order to provide additional capacity for future growth and limit the maximum net loss potential arising from the severity or frequency of insurance claims. These contracts do not relieve the Company from its obligation to policyholders. The amounts recoverable from reinsurers are estimated in a manner consistent with the reserve for losses associated with the related reinsurance contract.

Reinsurance recoverable activity is presented below:

	Years Ended December 31,		
	2019	2018	2017
Reinsurance recoverable on losses and loss expenses at January 1,	\$ 1,559,026	\$ 1,257,189	\$ 1,012,109
Incurring losses and loss expenses ceded	622,288	490,828	460,632
Paid losses and loss expenses ceded	322,396	191,695	218,963
Effect of foreign exchange rate changes	2,011	2,704	3,411
Reinsurance recoverable on losses and loss expenses at December 31,	1,860,929	1,559,026	1,257,189
Amounts currently due from reinsurers	82,277	34,859	70,195
Due from reinsurers	<u>\$ 1,943,206</u>	<u>\$ 1,593,885</u>	<u>\$ 1,327,384</u>

The Company regularly evaluates the financial condition of its reinsurers and monitors credit risk with respect to amounts recoverable under these contracts. Failure of reinsurers to honor their obligations could result in losses to the Company; consequently, allowances are established for amounts deemed uncollectible. In order to minimize this credit risk, the Company seeks to cede business to reinsurers generally rated "A-" or better by accredited rating agencies such as A.M. Best. The Company considers reinsurers that are not rated or do not fall within the prescribed rating categories and may grant exceptions to the general policy on a case-by-case basis. As of December 31, 2019 and 2018, 99 percent of the total reinsurance exposure was due from reinsurers rated "A-" or better.

To estimate the allowance for uncollectible reinsurance, the Company performs a default analysis consisting of a number of factors, including the amounts of ceded losses recoverable from the reinsurer and the credit rating of the reinsurer. As of December 31, 2019 and 2018, such allowance was approximately \$32,381 and \$28,465, respectively. There were no write-offs of ceded losses for the years ended December 31, 2019 and 2018. As of December 31, 2019 and 2018, reinsurance recoverables overdue from reinsurers for 90 days or more, net of allowance, were \$3,395 and \$3,478, respectively.

At December 31, 2019 and 2018, the Company's largest ceded loss recoverable exposure resided with three reinsurers, the largest was with the Underwriters at Lloyd's where the exposure was \$365,093 and \$288,097 at December 31, 2019 and 2018, respectively. The Company has reinsurance recoverables of \$249,458 and \$207,573, as of December 31, 2019 and 2018, respectively, from the second largest reinsurer who has an "A+" rating. The Company has reinsurance recoverables of \$205,947 and \$179,331, as of December 31, 2019 and 2018, respectively, from the third largest reinsurer who has an "A+" rating in 2019 and an "A" rating in 2018, reflecting different reinsurers.

# Associated Electric & Gas Insurance Services Limited

## Notes to the Consolidated Financial Statements (Expressed in thousands of U.S. dollars)

### 9. Income Taxes

The Company has received an undertaking from Bermuda that it will be exempt from any local profits, income or capital gains taxes until the year 2035. No such taxes are presently imposed in Bermuda. As a consolidated group however, the Company and its subsidiaries are subject to such taxes in other tax jurisdictions. The Company files U.S. and Canadian federal income tax returns. Furthermore, certain U.K. subsidiaries are required to file U.K. income tax returns, while certain business sourced in the U.K. are subject to U.S. tax under an Internal Revenue Code Section 953(d) election. The Company's Bermuda-based parent insurance company files a U.S. tax return pursuant to Internal Revenue Code Section 953(d) status. Electing Section 953(d) status allows the Company to combine its taxable income with certain subsidiary taxable income in a consolidated U.S. tax return.

The provision for income taxes for the years ended December 31, was as follows:

	<u>2019</u>	<u>2018</u>	<u>2017</u>
Current provision	\$ 5,522	\$ (11,535)	\$ 17,000
Deferred provision	20,961	37,734	10,050
Total income tax provision	<u>\$ 26,483</u>	<u>\$ 26,199</u>	<u>\$ 27,050</u>

The reconciliation between the Company's effective tax rate and the statutory tax rate was as follows:

	<u>Tax Effect 2019</u>	<u>Percent of Pre-Tax Income</u>	<u>Tax Effect 2018</u>	<u>Percent of Pre-Tax Income</u>	<u>Tax Effect 2017</u>	<u>Percent of Pre-Tax Income</u>
U.S. federal income tax at statutory rate	\$30,328	21.0%	\$ 26,523	21.0%	\$ 55,922	35.0%
Adjustments:						
Tax effect for Tax Cuts and Jobs Act	-	-	-	-	13,743	8.6
Net impact on foreign taxes	-	-	-	-	(34,914)	(21.8)
Change in valuation allowances	-	-	(1,237)	(1.0)	(2,594)	(1.6)
Company-owned officers' life insurance	(2,661)	(1.8)	616	0.5	(2,487)	(1.6)
Return-to-provision adjustments	(573)	(0.4)	840	0.6	483	0.3
Other permanent items	(611)	(0.5)	(543)	(0.4)	(3,103)	(1.9)
Total income tax provision	<u>\$26,483</u>	<u>18.3%</u>	<u>\$ 26,199</u>	<u>20.7%</u>	<u>\$ 27,050</u>	<u>17.0%</u>

The TCJA was enacted in the U.S. on December 22, 2017. TCJA reduced the US federal corporate income tax rate to 21% from 35%, required companies to pay a one-time transition tax on the earnings of certain foreign subsidiaries that were previously tax deferred, and created new taxes on certain foreign-sourced earnings. During 2017, as a result of the enactment of the TCJA and consistent with Staff Accounting Bulletin 118, the Company recorded provisional amounts for the impact of various provisions of the new law. During 2018, the Company completed its accounting for the law change and recorded various measurement period adjustments with an immaterial impact on the consolidated financial statements.

# Associated Electric & Gas Insurance Services Limited

## Notes to the Consolidated Financial Statements (Expressed in thousands of U.S. dollars)

The Company's deferred income tax assets and liabilities as of December 31, are summarized below:

	2019	2018
Deferred tax assets:		
Loss reserves	\$ 40,834	\$ 43,001
Net operating loss carryforwards	1,715	1,715
Unearned premiums	19,117	17,124
Alternative minimum tax credits	3,842	8,526
Foreign tax credit carryforwards	-	19,023
Basis difference in investments	-	17,394
Anticipatory foreign tax credit	423	3,430
Profit commission and other accruals	10,441	10,248
Compensation and benefit accruals	23,235	19,166
Syndicate technical account	1,872	7,193
Other deferred tax assets	1,337	1,923
Gross deferred tax assets	102,816	148,743
Less valuation allowance	-	-
Deferred tax assets	102,816	148,743
Deferred tax liabilities:		
Unrealized investment gains on securities—net	10,255	7,734
Change in fair value of insurance and reinsurance contracts	28,820	40,829
Fixed asset basis difference	683	847
Deferred acquisition costs	6,820	6,431
TCJA transition adjustment	4,551	8,784
Claims equalization reserve	3,792	6,117
Basis difference in investments	908	-
Other deferred tax liabilities	-	2,559
Deferred tax liabilities	55,829	73,301
Net deferred tax asset	\$ 46,987	\$ 75,442

The Company has \$1,715 of tax-effected state net operating loss carryforwards available to offset state taxable income in future years. These net operating losses will expire between 2033 and 2037. The Company has \$3,842 in alternative minimum tax credits, which under the TCJA will be fully refunded to the Company by December 31, 2021, due to the repeal of the corporate alternative minimum tax. The Company has utilized all of its foreign tax credit carryovers.

Management believes that based on its historical pattern of taxable income, the Company will more likely than not produce sufficient taxable income in the future to realize its deferred tax assets.

The IRS can examine 2008-2014 tax years with respect to foreign tax credits. The 2015-2018 tax years are open to audit with respect to all income tax matters, including utilization of tax attributes (including net operating loss carryforwards) generated in prior years. The Company is under examination by the IRS with respect to its 2015 U.S. consolidated tax return. No adjustments have been proposed to date.

At December 31, 2019 and 2018, the Company had no uncertain tax positions for which it is reasonably possible that the total amounts of unrecognized tax benefits will significantly increase or decrease within the next 12 months.



# Associated Electric & Gas Insurance Services Limited

## Notes to the Consolidated Financial Statements (Expressed in thousands of U.S. dollars)

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### 10. Policyholders' Liability

The liability of each policyholder of the Company is limited to any unpaid premiums due to the Company from such policyholders and for premiums, if any, relating to the Company's retrospective premium plans.

Retrospective premium plans were retroactively discontinued for all policies incepting on or after January 1, 1988. Management is unaware of any events that would cause the application of any of the retrospective premium plans remaining in effect.

### 11. Commitments and Contingencies

The Company has established reserves for losses and loss expenses for claims that arise in the ordinary course of business. The Company is also subject to legal proceedings and regulatory inquiries, for which there is currently no provision established as management does not believe that the outcome of any of these matters will have a material adverse effect on the Company's financial position, operating results, or cash flows.

#### Operating Leases

The Company leases office space and equipment under various operating lease arrangements, which expire at various dates through 2027. Rent expense is recorded in other underwriting expenses in the consolidated statement of income and for the years ended December 31, 2019, 2018 and 2017 was \$4,910, \$4,666 and \$4,340, respectively. Rental commitments for AEGIS London offices are reflected through the end of the lease term, which is August 2020. AEGIS London is in the process of negotiating a new lease agreement.

The Company's aggregate minimum rental commitments as of December 31, 2019 are as follows:

<b>Year</b>	<b>Amount</b>
2020	\$ 3,047
2021	2,565
2022	2,505
2023	2,482
2024	2,516
Years thereafter until 2027	6,220
Total	<u>\$ 19,335</u>

#### Unfunded Commitments

The Company has entered into investment agreements, and under the terms of the agreements, the Company may be required to invest additional amounts to meet its various unfunded contractual commitments, summarized below:

As of December 31, 2019 and 2018, the Company's limited partnership investments had a fair value of \$174,402 and \$95,951, respectively, with unfunded commitments totaling \$91,022 at December 31, 2019.

# Associated Electric & Gas Insurance Services Limited

## Notes to the Consolidated Financial Statements (Expressed in thousands of U.S. dollars)

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As of December 31, 2019 and 2018, the Company's REIT investments had a fair value of \$205,970 and \$185,685, respectively, with unfunded commitments totaling \$20,000 at December 31, 2019.

As of December 31, 2019 and 2018, the Company's mortgage loan investments had a fair value of \$201,428 and \$173,633, respectively, with unfunded commitments totaling \$5,064 at December 31, 2019.

### Securities on Deposit and Letters of Credit

At December 31, 2019, the Company had securities and cash on deposit of \$857,087 in order to comply with various U.S., Canadian and U.K. insurance and tax regulatory requirements. The Company also maintained letter of credit facilities with four financial institutions totaling \$418,578, of which \$408,109 was committed at December 31, 2019. At December 31, 2019, the Company had pledged assets of cash and debt securities, valued at \$637,514, as collateral to secure these letters of credit.

### 12. Dividend Restrictions

No dividend transfers occurred in 2019 and 2018. At December 31, 2019 and 2018, there were no significant restrictions on the payment of dividends from AISL to AEGIS London Holding.

In 2019, there was a transfer of capital of \$50 million from AEGIS to AEGIS London Holding which in turn transferred the \$50 million to AISL.

### 13. Subsequent Events

AEGIS has evaluated all events subsequent to December 31, 2019 through the consolidated financial statements issuance date of April 2, 2020, and other than as described below, there are no events to disclose.

The world is currently in the midst of a global health pandemic caused by a novel coronavirus (COVID-19). Due to the seriousness of the pandemic, governments and non-governmental organizations have taken significant steps to combat the spread of the virus, which has included severely restricting travel, requiring businesses' employees to work from home, closing some businesses and non-essential services, furloughing or terminating workers, and other measures. These actions, on top of the global health pandemic, has had and is expected to continue to have a profound impact on the global economy and financial markets. Given the uncertainty surrounding the pandemic and the impact of actions taken by governments and non-government organizations, it is difficult to assess the financial impact on the Company.

Risks to the Company stemming from the pandemic include the potential effect to its investment performance, claims and claim liabilities, and reinsurance availability and pricing. A positive offset may come from the CAREs Act, recently passed by Congress which has favorable tax implications. The Company is currently in the process of assessing its insurance policy exposures in terms of business continuity coverage, workers' compensation, employer's liability and other coverages. While management cannot estimate the financial impact of the pandemic at this time, management believes that the Company is in a strong liquidity and capital position.

### 14. Margin of Solvency

The Company is registered under the Bermuda Insurance Act of 1978 and related regulations, which require that the Company maintain a minimum solvency margin of approximately \$347 million for solvency and liquidity. As a Class 3 insurer, the policyholders' surplus at December 31, 2019 was in excess of the minimum solvency margin required.

# Associated Electric & Gas Insurance Services Limited

## Notes to the Consolidated Financial Statements (Expressed in thousands of U.S. dollars)

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### 15. Operating Results by Line of Business

Management has elected to present its operating results into two lines of business, General Liability and Directors and Officers Liability. General Liability includes excess liability, fiduciary and employee benefits liability, professional liability and excess workers' compensation insurance. Directors & Officers Liability includes directors and officers liability and general partner liability insurance. Operating expenses directly attributable to a given line of business are charged correspondingly; the remainder is allocated based upon their respective share of gross written premiums. Investment results and the results from all other lines of business are allocated to each line of business based upon its proportionate share of unearned premiums, reserve for losses and loss expenses, and total surplus. This presentation is utilized to determine continuity credits, when declared by the Board of Directors of AEGIS, as they are earned by members based upon their individual proportionate shares of premiums and surplus attributable to the Company's General Liability and Directors & Officers Liability lines of business, as defined in the Company's bylaws.

# Associated Electric & Gas Insurance Services Limited

## Notes to the Consolidated Financial Statements (Expressed in thousands of U.S. dollars)

Total surplus supports all insurance policies issued by the Company, regardless of type. The amounts of total surplus allocated by line of business are presented solely for informational purposes.

	General Liability			Directors & Officers Liability			Total		
	2019	2018	2017	2019	2018	2017	2019	2018	2017
Revenue:									
Net premiums earned	\$ 816,577	\$ 737,288	\$ 661,778	\$ 255,206	\$ 223,740	\$ 190,353	\$ 1,071,783	\$ 961,028	\$ 852,131
Net investment income	150,991	40,054	102,324	67,990	18,019	45,611	218,981	58,073	147,935
Change in fair value of insurance and reinsurance contracts	(59,873)	(1,630)	(31,284)	-	-	-	(59,873)	(1,630)	(31,284)
Total revenue	<u>907,695</u>	<u>775,712</u>	<u>732,818</u>	<u>323,196</u>	<u>241,759</u>	<u>235,964</u>	<u>1,230,891</u>	<u>1,017,471</u>	<u>968,782</u>
Expenses:									
Losses and loss expenses incurred	596,036	469,982	427,440	157,122	124,745	140,465	753,158	594,727	567,905
Commission expenses	94,237	84,294	67,748	42,801	38,046	30,424	137,038	122,340	98,172
Other underwriting expenses	100,909	95,418	76,840	36,551	33,971	28,251	137,460	129,389	105,091
Total expenses	<u>791,182</u>	<u>649,694</u>	<u>572,028</u>	<u>236,474</u>	<u>196,762</u>	<u>199,140</u>	<u>1,027,656</u>	<u>846,456</u>	<u>771,168</u>
Income before continuity and other premium credits and income taxes	116,513	126,018	160,790	86,722	44,997	36,824	203,235	171,015	197,614
Continuity and other premium credits	<u>25,237</u>	<u>14,953</u>	<u>10,645</u>	<u>33,580</u>	<u>29,756</u>	<u>27,192</u>	<u>58,817</u>	<u>44,709</u>	<u>37,837</u>
Income before income taxes	91,276	111,065	150,145	53,142	15,241	9,632	144,418	126,306	159,777
Income tax provision	<u>16,737</u>	<u>23,037</u>	<u>25,419</u>	<u>9,746</u>	<u>3,162</u>	<u>1,631</u>	<u>26,483</u>	<u>26,199</u>	<u>27,050</u>
Net income	74,539	88,028	124,726	43,396	12,079	8,001	117,935	100,107	132,727
Other comprehensive (loss) income	25,049	(16,598)	(3,087)	3,441	(4,646)	(1,073)	28,490	(21,244)	(4,160)
Total surplus—beginning of year	<u>610,881</u>	<u>539,451</u>	<u>417,812</u>	<u>1,025,247</u>	<u>1,017,814</u>	<u>1,010,886</u>	<u>1,636,128</u>	<u>1,557,265</u>	<u>1,428,698</u>
Total surplus—end of year	<u>\$ 710,469</u>	<u>\$ 610,881</u>	<u>\$ 539,451</u>	<u>\$ 1,072,084</u>	<u>\$ 1,025,247</u>	<u>\$ 1,017,814</u>	<u>\$ 1,782,553</u>	<u>\$ 1,636,128</u>	<u>\$ 1,557,265</u>