

Associated Electric & Gas Insurance Services Limited

Consolidated Financial Statements as of
December 31, 2020 and 2019 and for the
Years Ended December 31, 2020, 2019 and 2018 and
Independent Auditors' Report

Associated Electric & Gas Insurance Services Limited

TABLE OF CONTENTS

| | Page |
|---|-------------|
| Independent Auditors' Report | 1-2 |
| Consolidated Financial Statements as of December 31, 2020 and 2019 and for the years ended December 31, 2020, 2019 and 2018: | |
| Balance Sheets | 3 |
| Statements of Income and Comprehensive Income | 4 |
| Statements of Changes in Surplus | 5 |
| Statements of Cash Flows | 6 |
| Notes to Consolidated Financial Statements | 7-51 |

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, 2020 and 2019, 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, 2020, 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, 2020 and 2019, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2020 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 2020 within Note 8 to the consolidated financial statements be presented to supplement the basic consolidated financial statements. Such information, although not a part of the basic consolidated 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 consolidated 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 consolidated financial statements, and other knowledge we obtained during our audit of the basic consolidated 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, 2021

Associated Electric & Gas Insurance Services Limited

Consolidated Balance Sheets As of December 31, 2020 and 2019 (Expressed in thousands of U.S. dollars)

| | 2020 | 2019 |
|---|---------------------|---------------------|
| Assets | | |
| Cash and cash equivalents ⁽¹⁾ | \$ 513,791 | \$ 389,474 |
| Investments (held at fair value: 2020 - \$3,320,912; 2019 - \$2,871,958) ⁽¹⁾ | 4,533,726 | 4,116,213 |
| Mortgage loans, net of valuation allowance | <u>188,120</u> | <u>198,482</u> |
| Total cash and investments | 5,235,637 | 4,704,169 |
| Due from reinsurers | 2,108,345 | 1,943,206 |
| Due from insureds | 1,562 | 11,601 |
| Accrued interest ⁽¹⁾ | 20,100 | 25,085 |
| Premiums receivable | 376,202 | 324,006 |
| Receivable for securities sold | 1,199 | 28,835 |
| Current income taxes receivable ⁽¹⁾ | 3,607 | 23,395 |
| Unearned continuity and other premium credits | 29,503 | 31,470 |
| Prepaid reinsurance premiums ⁽¹⁾ | 387,024 | 347,829 |
| Net deferred tax asset ⁽¹⁾ | 51,914 | 46,987 |
| Deferred acquisition costs | 92,064 | 95,914 |
| Deposit assets | 129,237 | 123,980 |
| Other assets | <u>193,233</u> | <u>161,687</u> |
| Total Assets | <u>\$ 8,629,627</u> | <u>\$ 7,868,164</u> |
| Liabilities and Surplus | | |
| Liabilities: | | |
| Reserve for losses and loss expenses | \$ 4,351,822 | \$ 4,028,487 |
| Unearned premiums | 1,167,066 | 1,021,447 |
| Fair value of insurance and reinsurance contracts | 581,429 | 532,628 |
| Due to reinsurers ⁽¹⁾ | 254,554 | 218,699 |
| Payable for securities purchased | 82,414 | 13,824 |
| Deposit liabilities | 129,237 | 123,980 |
| Accrued expenses and other liabilities ⁽¹⁾ | <u>162,871</u> | <u>146,546</u> |
| Total liabilities | <u>6,729,393</u> | <u>6,085,611</u> |
| Commitments and Contingencies | | |
| Surplus: | | |
| Statutory surplus fund | 250 | 250 |
| Policyholders' surplus ⁽¹⁾ | 1,858,570 | 1,743,723 |
| Accumulated other comprehensive income | <u>41,414</u> | <u>38,580</u> |
| Total surplus | <u>1,900,234</u> | <u>1,782,553</u> |
| Total Liabilities and Surplus | <u>\$ 8,629,627</u> | <u>\$ 7,868,164</u> |

⁽¹⁾ 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, 2020, 2019 and 2018 (Expressed in thousands of U.S. dollars)

| | 2020 | 2019 | 2018 |
|---|-------------------|-------------------|-------------------|
| Revenue: | | | |
| Gross premiums written | \$2,092,383 | \$1,815,733 | \$1,567,145 |
| Net premiums written | <u>1,322,551</u> | <u>1,156,788</u> | <u>1,028,021</u> |
| Net premiums earned | 1,213,640 | 1,071,783 | 961,028 |
| Net investment income | 112,999 | 218,981 | 58,073 |
| Change in fair value of insurance and reinsurance contracts | (45,684) | (59,873) | (1,630) |
| Total revenue | <u>1,280,955</u> | <u>1,230,891</u> | <u>1,017,471</u> |
| Expenses: | | | |
| Losses and loss expenses incurred | 795,950 | 753,158 | 594,727 |
| Commission expenses | 149,883 | 137,038 | 122,340 |
| Other underwriting expenses | 131,122 | 137,460 | 129,389 |
| Total expenses | <u>1,076,955</u> | <u>1,027,656</u> | <u>846,456</u> |
| Income before continuity and other premium credits and income taxes | 204,000 | 203,235 | 171,015 |
| Continuity and other premium credits | 63,346 | 58,817 | 44,709 |
| Income before income taxes | <u>140,654</u> | <u>144,418</u> | <u>126,306</u> |
| Income Taxes: | | | |
| Current provision | 33,855 | 5,522 | (11,535) |
| Deferred provision | (5,468) | 20,961 | 37,734 |
| Total income tax provision | <u>28,387</u> | <u>26,483</u> | <u>26,199</u> |
| Net Income | <u>\$ 112,267</u> | <u>\$ 117,935</u> | <u>\$ 100,107</u> |
| Other Comprehensive Income (Loss): | | | |
| Unrealized gains (losses) on securities: | | | |
| Unrealized holding (losses) gains arising during the year from available-for-sale securities (net of income tax benefit (expense) of \$248, \$(7,977), and \$16,434, respectively) | (934) | 30,007 | (61,610) |
| Unrealized holding gains, on held-to-maturity securities reclassified from available-for-sale, arising during the year (net of income tax (expense) of (\$287), (\$332), and (\$504), respectively) | 1,078 | 1,251 | 1,895 |
| Reclassification adjustment for amounts included in net income (loss) (net of income tax (expense) benefit \$(715), \$736, and (\$10,226), respectively) | 2,690 | (2,768) | 38,471 |
| Other comprehensive income (loss) | <u>2,834</u> | <u>28,490</u> | <u>(21,244)</u> |
| Comprehensive Income | <u>\$ 115,101</u> | <u>\$ 146,425</u> | <u>\$ 78,863</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, 2020, 2019 and 2018 (Expressed in thousands of U.S. dollars)

| | 2020 | 2019 | 2018 |
|---|---------------------|---------------------|---------------------|
| Statutory Surplus Fund | \$ 250 | \$ 250 | \$ 250 |
| Policyholders' Surplus: | | | |
| Balance at January 1 | 1,743,723 | 1,606,780 | 1,514,832 |
| Cumulative change in accounting principle, net of tax ^(*) | - | 19,008 | (8,159) |
| Other surplus adjustments | 2,580 | - | - |
| Net income | 112,267 | 117,935 | 100,107 |
| Balance at December 31 | <u>1,858,570</u> | <u>1,743,723</u> | <u>1,606,780</u> |
| Accumulated Other Comprehensive Income: | | | |
| Balance at January 1 | 38,580 | 29,098 | 42,183 |
| Other comprehensive income (loss) | 2,834 | 28,490 | (21,244) |
| Reclassification to cumulative change in accounting principle, net of tax ^(*) | <u>-</u> | <u>(19,008)</u> | <u>8,159</u> |
| Balance at December 31 | <u>41,414</u> | <u>38,580</u> | <u>29,098</u> |
| Total Surplus at December 31 | <u>\$ 1,900,234</u> | <u>\$ 1,782,553</u> | <u>\$ 1,636,128</u> |

^(*) 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, 2020, 2019 and 2018 (Expressed in thousands of U.S. dollars)

| | 2020 | 2019 | 2018 |
|--|--------------------|-------------------|-------------------|
| Cash Flows From Operating Activities: | | | |
| Net income | \$ 112,267 | \$ 117,935 | \$ 100,107 |
| Net investment (gains) losses on securities | (14,236) | (92,424) | 52,855 |
| Net investment foreign exchange losses | 2,200 | 6,113 | 758 |
| Amortization of securities | 9,852 | (5,871) | 7,701 |
| Depreciation, capitalization and other charges | 1,811 | 1,786 | 2,099 |
| Deferred income tax expense | (5,468) | 20,961 | 37,733 |
| Change in variable interest entities | 2,580 | - | - |
| Changes in assets and liabilities: | | | |
| Due from reinsurers | (165,139) | (349,321) | (266,501) |
| Due from insureds | 10,039 | (11,510) | (237) |
| Accrued interest | 4,985 | (2,982) | 555 |
| Premiums receivable | (52,196) | (67,105) | (34,516) |
| Current income taxes receivable | 19,788 | 9,183 | (19,428) |
| Unearned continuity and other premium credits | 1,967 | (2,047) | (3,166) |
| Prepaid reinsurance premiums | (39,195) | (69,749) | (32,755) |
| Deferred acquisition costs | 3,850 | (8,849) | (20,756) |
| Deposit assets | (5,257) | (715) | (1,612) |
| Other assets | (33,568) | (26,780) | 7,994 |
| Reserve for losses and loss expenses | 323,335 | 368,655 | 353,215 |
| Unearned premiums | 145,619 | 153,403 | 103,386 |
| Fair value of insurance and reinsurance contracts | 48,801 | 60,571 | 11,658 |
| Due to reinsurers | 35,855 | 59,662 | 13,901 |
| Deposit liabilities | 5,257 | 715 | 1,612 |
| Accrued expenses and other liabilities | 16,748 | 7,694 | (1,765) |
| Net cash provided by operating activities | <u>429,895</u> | <u>169,325</u> | <u>312,838</u> |
| Cash Flows From Investing Activities: | | | |
| Purchases of available-for-sale debt securities, equity securities, and other investments | (8,201,213) | (3,721,465) | (3,097,491) |
| Purchases of mortgage loans | (19,698) | (53,846) | (44,989) |
| Purchases of held-to-maturity investments | (296,554) | (199,563) | (149,023) |
| Proceeds from sales or redemptions of available-for-sale debt securities, equity securities, and other investments | 7,834,619 | 3,719,090 | 2,795,700 |
| Proceeds from sales of mortgage loans | 30,131 | 28,026 | 25,410 |
| Proceeds from maturities and mandatory redemptions of held-to-maturity investments | 344,786 | 182,875 | 131,848 |
| Net cash utilized in investing activities | <u>(307,929)</u> | <u>(44,883)</u> | <u>(338,545)</u> |
| Effect of Exchange Rate Changes on Cash | <u>2,351</u> | <u>(670)</u> | <u>2,537</u> |
| Increase (Decrease) in Cash and Cash Equivalents | 124,317 | 123,772 | (23,170) |
| Cash and Cash Equivalents, Beginning of Year | <u>389,474</u> | <u>265,702</u> | <u>288,872</u> |
| Cash and Cash Equivalents, End of Year | <u>\$ 513,791</u> | <u>\$ 389,474</u> | <u>\$ 265,702</u> |
| Supplemental disclosures of cash flow information: | | | |
| Net cash paid (received): | | | |
| Income tax payments (receipts) | <u>\$ (13,870)</u> | <u>\$ 3,920</u> | <u>\$ (3,240)</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)

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”). For the years ended December 31, 2020, 2019 and 2018, the Company provided a net capacity for AEGIS London of 97, 93 and 93 percent, respectively.

Recent Developments

The novel coronavirus (COVID-19) spread rapidly across the world in 2020 and was declared a pandemic by the World Health Organization. Due to the seriousness of the pandemic, governments and non-governmental organizations took significant steps to combat the spread of the virus, which included severely restricting travel, requiring businesses’ employees to work from home, closing some businesses and non-essential services, furloughing or terminating workers, as well as other measures. Currently, various levels of restrictions are still in place across the U.S. and globally to address the spread.

The duration and extent of the effects of the ongoing pandemic over the longer term is difficult to predict, as it depends on the time necessary to distribute vaccines to significant amounts of people in the U.S. and throughout the world, and the social and political influences that will shape the economic recovery.

Risks to the Company stemming from the pandemic include the risk of virus mutations, the potential effect of the economy on the Company’s investment performance, claims and claim liabilities, and reinsurance availability and pricing. Estimates used in the preparation of financial statements are subject to change particularly those associated with insurance and reinsurance contracts and assumptions used in the pricing of securities. 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.

Associated Electric & Gas Insurance Services Limited

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

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.

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 Other Comprehensive Income ("OCI"). The amortized cost of debt securities includes both the amortization of premium and the accretion of discounts.

Associated Electric & Gas Insurance Services Limited

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

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. As of January 1, 2019, AOCI related to the Company's equity investments were reclassified via a one-time adjustment from AOCI to policyholders' surplus.

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 cost. 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 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, 2020 and 2019 were considered other-than-temporary and recorded as a charge to net investment income.

Associated Electric & Gas Insurance Services Limited

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

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, 2020 and 2019, the Company's net traded but unsettled syndicated bank loans totaled \$2,304 and \$2,015, 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 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, 2020 and 2019. 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. These limited partnership investments would be classified as Level 3 investments, as determined based on the Company's fair value measurement framework.

Associated Electric & Gas Insurance Services Limited

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

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 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, 2020 and 2019, 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 enters into 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.

Associated Electric & Gas Insurance Services Limited

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

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, 2020, 2019 and 2018, the Company invested in foreign currency forward contracts with a notional balance of \$25,000, respectively, denominated in Canadian dollars. The unrealized gain (loss) recorded from foreign currency forward contracts for 2020, 2019 and 2018 was \$175, (\$1,018) and \$546, respectively, which is reflected in net investment income. The realized gain (loss) associated with foreign currency forward contracts for 2020, 2019 and 2018 was \$(532), \$180 and \$687, 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 \$6,959, \$3,136 and (\$2,745) for the years ended December 31, 2020, 2019 and 2018, 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's financial results relate to the method of estimation of loss reserves.

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

Associated Electric & Gas Insurance Services Limited

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

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.

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 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

Associated Electric & Gas Insurance Services Limited

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

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 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.

Associated Electric & Gas Insurance Services Limited

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

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:

| | 2020 | 2019 |
|---|-----------------|-----------------|
| Property and leasehold improvements | \$ 8,739 | \$ 8,244 |
| Furniture and fixtures | 6,879 | 3,390 |
| Information technology equipment and software | 21,235 | 19,315 |
| Total cost | 36,853 | 30,949 |
| Accumulated depreciation/capitalization | (28,566) | (27,269) |
| Net property and equipment | <u>\$ 8,287</u> | <u>\$ 3,680</u> |

Depreciation and capitalization expense amounted to \$1,811, \$1,786, and \$2,099 for the years ended December 31, 2020, 2019 and 2018, respectively. There were no gains related to the disposal of the Company's property and equipment during the years ended 2020, 2019 and 2018.

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, 2020 and 2019, the total projected benefit obligation for the Pension Plan and the non-qualified plan was \$39,400 and \$39,111, respectively. The fair value of Pension Plan assets as of December 31, 2020 and 2019 was \$29,654 and \$29,033,

Associated Electric & Gas Insurance Services Limited

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

respectively, and the total unfunded balance was \$9,745 and \$10,077, respectively. The Company's projected benefit obligation for the Pension Plan were based on blended discount rates in 2020 and a 4.25% discount rate in 2019. The projected benefit obligation for the non-qualified plan was based on a discount rate of 2.00% in 2020 and a 2.75% discount rate for 2019, with a 3.00% rate of compensation increase for the non-qualified Plan in 2020 and 2019. The expected rate of return on Pension Plan assets was 3.50% for 2020 and 2019, 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 were made to participants as a favorable determination letter was not obtained from the Internal Revenue Service. During 2020, the Company decided to revoke its termination of the Plan as a result of the disruptions and uncertainties caused by the COVID-19 pandemic. As a result, the Plan did not implement the liquidation basis of accounting.

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, 2020 and 2019, the unfunded balance related to this plan was \$9,936 and \$9,895, respectively. The Company's obligations under the plan were based upon a discount rate of 2.75% for 2020 and 3.50% for 2019.

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.

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 superseded the previous revenue recognition guidance under U.S. GAAP. For those contracts that were impacted by the new guidance an entity was 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 changed 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 amended certain disclosure requirements associated with the fair value of financial instruments. The Company adopted this ASU in 2019, under the retrospective method, and identified its equity investments as equity securities,

Associated Electric & Gas Insurance Services Limited

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

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 required 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 has 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 had 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 required 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 allowed only the service cost component to be eligible for capitalization when applicable. The guidance was 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.

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 the Tax Cuts and Job Act ("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 was recorded within AOCI was considered "stranded". ASU 2018-02 allowed 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.

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 was effective for fiscal years beginning after December 15, 2019. The guidance modified 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 has adopted the modified footnote disclosures in the consolidated financial statements.

Associated Electric & Gas Insurance Services Limited

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

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 June 2020, the FASB issued ASU 2020-05 which provided new effective dates for *Leases (Topic 842)*. For nonpublic entities, it is effective for annual reporting periods beginning after December 15, 2021.

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 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*

Associated Electric & Gas Insurance Services Limited

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

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 balance sheet after the date of adoption of this ASU. The Company is currently evaluating the impact of the new guidance on its consolidated financial statements.

In March 2020, the FASB issued ASU 2020-04, *Reference Rate Reform (Topic 848) Facilitation of the Effects of Reference Rate Reform on Financial Reporting*. The new guidance reduces the operational and financial impacts of contract modifications that replace a reference rate, such as London Interbank Offered Rate (LIBOR). It applies to contracts and hedging relationships, and other transactions affected, provided certain criteria are met. The Company will continue to evaluate the impacts of reference rate reform on contract modifications to determine the effect on its consolidated financial statements, and is reviewing its investment and mortgage loan portfolios to determine the scope of contracts and transactions impacted. The expedients and exceptions provided by the amendments do not apply to contract modifications made and hedging relationships entered into or evaluated after December 31, 2022, with certain exceptions.

Associated Electric & Gas Insurance Services Limited

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, 2020 | | | | Value on Balance Sheet |
|---|----------------------------|-------------------|-------------------|---------------------|---------------------------|
| | Cost/ Amortized Cost | Gross Unrealized | | Fair Value | |
| | | Gains | Losses (*) | | |
| Held-to-maturity: | | | | | |
| Debt securities: | | | | | |
| U.S. corporate debt securities | \$ 567,717 | \$ 34,302 | \$ (257) | \$ 601,762 | \$ 567,717 |
| Foreign corporate debt securities | 141,137 | 4,928 | (30) | 146,035 | 141,137 |
| Agency MBS | 379,156 | 14,536 | (816) | 392,876 | 379,156 |
| Non-agency MBS and ABS | 124,804 | 4,286 | (10) | 129,080 | 124,804 |
| Total HTM investments | <u>1,212,814</u> | <u>58,052</u> | <u>(1,113)</u> | <u>1,269,753</u> | <u>1,212,814</u> |
| Available-for-sale: | | | | | |
| Debt securities: | | | | | |
| U.S. Treasury securities and obligations of U.S. government corporations and agencies | 523,153 | 1,906 | - | 525,059 | 525,059 |
| Debt securities issued by foreign governments | 275,865 | 14,364 | - | 290,229 | 290,229 |
| U.S. corporate debt securities | 531,191 | 13,257 | - | 544,448 | 544,448 |
| Foreign corporate debt securities | 154,387 | 2,274 | - | 156,661 | 156,661 |
| Agency MBS | 455,654 | 10,499 | - | 466,153 | 466,153 |
| Non-agency MBS and ABS | 327,602 | 2,266 | - | 329,868 | 329,868 |
| Syndicated bank loans/Direct lending | 119,163 | 879 | (1,039) | 119,003 | 119,003 |
| Total AFS investments | <u>2,387,015</u> | <u>45,445</u> | <u>(1,039)</u> | <u>2,431,421</u> | <u>2,431,421</u> |
| Equity securities(**): | | | | | |
| Equity securities/REITs | 374,586 | 25,288 | - | 399,874 | 399,874 |
| Mutual fund bonds | 181,677 | 9,740 | - | 191,417 | 191,417 |
| Total equity securities | <u>556,263</u> | <u>35,028</u> | <u>-</u> | <u>591,291</u> | <u>591,291</u> |
| Other invested assets(**): | | | | | |
| Limited partnership/Direct lending | 199,487 | 1,180 | (1,569) | 199,098 | 199,098 |
| Convertible securities | 81,450 | 17,673 | (614) | 98,509 | 98,509 |
| Fund of funds | 593 | 3 | (3) | 593 | 593 |
| Total other invested assets | <u>281,530</u> | <u>18,856</u> | <u>(2,186)</u> | <u>298,200</u> | <u>298,200</u> |
| Total investments | <u>\$ 4,437,622</u> | <u>\$ 157,381</u> | <u>\$ (4,338)</u> | <u>\$ 4,590,665</u> | <u>\$ 4,533,726</u> |
| Mortgage loans, net of valuation allowance | | | | | |
| | <u>\$ 188,120</u> | <u>\$ N/A</u> | <u>\$ N/A</u> | <u>\$ 192,499</u> | <u>\$ 188,120</u> |
| Cash and cash equivalents | | | | | |
| | <u>\$ 513,791</u> | <u>\$ N/A</u> | <u>\$ N/A</u> | <u>\$ 513,791</u> | <u>\$ 513,791</u> |

(*) As of December 31, 2020, no gross unrealized losses are reported for AFS investments excluding direct lending losses, 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

Associated Electric & Gas Insurance Services Limited

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

| | December 31, 2019 | | | | |
|---|----------------------------|-------------------|-------------------|---------------------|---------------------------|
| | Cost/ Amortized Cost | Gross Unrealized | | Fair Value | Value on Balance Sheet |
| | | Gains | Losses (*) | | |
| Held-to-maturity: | | | | | |
| 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> |
| Available-for-sale: | | | | | |
| 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> |
| Equity securities(**): | | | | | |
| Equity securities/REITs | 179,629 | 26,483 | - | 206,112 | 206,112 |
| Mutual funds 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> |
| Other invested assets(**): | | | | | |
| 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> |
| Total investments | <u>\$ 4,038,987</u> | <u>\$ 104,633</u> | <u>\$ (7,777)</u> | <u>\$ 4,135,843</u> | <u>\$ 4,116,213</u> |
| Mortgage loans, net of valuation allowance | <u>\$ 198,482</u> | <u>\$ N/A</u> | <u>\$ N/A</u> | <u>\$ 201,428</u> | <u>\$ 198,482</u> |
| Cash and cash equivalents | <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

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:

| | 2020 | 2019 | 2018 |
|--|--------------|--------------|--------------|
| Purchases | \$ 8,087,952 | \$ 3,573,545 | \$ 2,965,174 |
| Proceeds from sales | 5,707,907 | 2,335,192 | 1,510,549 |
| Gross gains | 34,165 | 80,191 | 36,546 |
| Gross losses(*) | 49,394 | 10,818 | 89,844 |
| Other-than-temporary impairment recognized | 1,918 | 2,833 | 83,212 |

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

Held-to-Maturity Investments

Proceeds from maturities of HTM investments were \$118,317, \$145,040 and \$100,251 for the years ended December 31, 2020, 2019 and 2018, 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, 2020, 2019 and 2018, 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, 2020 and 2019, 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, 2020, 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 | \$ 206,672 | \$ 208,778 | \$ 114,078 | \$ 115,096 |
| Due after one year through five years | 1,227,332 | 1,252,754 | 377,271 | 395,158 |
| Due after five years through ten years | 133,290 | 138,442 | 44,773 | 47,054 |
| Due after ten years | 36,465 | 35,426 | 172,732 | 190,489 |
| Subtotal | 1,603,759 | 1,635,400 | 708,854 | 747,797 |
| Agency MBS | 455,654 | 466,153 | 379,156 | 392,876 |
| Non-agency MBS and ABS | 327,602 | 329,868 | 124,804 | 129,080 |
| Total debt securities | <u>\$ 2,387,015</u> | <u>\$ 2,431,421</u> | <u>\$ 1,212,814</u> | <u>\$ 1,269,753</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, 2020 and 2019 was comprised of investment securities on loan having a fair value of \$3,205 and \$6,937, respectively, while the cash collateral from borrowers was \$3,275 and \$7,080 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:

| | 2020 | 2019 | 2018 |
|----------------------|-------------|-------------|-------------|
| Purchases | \$ 113,261 | \$ 147,920 | \$ 132,317 |
| Proceeds from sales | 100,731 | 72,980 | 82,624 |
| Net recognized gains | 23,853 | 16,191 | 954 |

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

| | 2020 | 2019 | 2018 |
|--|-------------|-------------|-------------|
| Interest and dividend income | \$ 118,193 | \$ 154,332 | \$ 135,918 |
| Net realized investment gains (losses) | 13 | 74,708 | (45,603) |
| Net realized foreign currency losses | (2,200) | (5,095) | (3,653) |
| Net unrealized investment gains (losses) | 14,061 | 17,716 | (7,266) |
| Net unrealized gains (losses) on foreign currency forward contracts | 175 | (1,018) | 546 |
| Total investment income | 130,242 | 240,643 | 79,942 |
| Investment expenses | (17,243) | (21,662) | (21,869) |
| Net investment income | \$ 112,999 | \$ 218,981 | \$ 58,073 |

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, 2020 | | | | Total |
|---|-------------------|--------------|------------|-------------------------------------|--------------|
| | Level 1 | Level 2 | Level 3 | Investments Valued at NAV (*) | |
| Assets: | | | | | |
| Investments: | | | | | |
| Debt securities | | | | | |
| U.S. Treasury securities and obligations of U.S. government corporations and agencies | \$ - | \$ 525,059 | \$ - | \$ - | \$ 525,059 |
| Debt securities issued by foreign governments | - | 290,229 | - | - | 290,229 |
| U.S. corporate debt securities | - | 544,448 | - | - | 544,448 |
| Foreign corporate debt securities | - | 156,661 | - | - | 156,661 |
| Agency MBS | - | 466,153 | - | - | 466,153 |
| Non-Agency MBS and ABS | - | 329,868 | - | - | 329,868 |
| Syndicated bank loans/Direct lending | - | 86,392 | 32,611 | - | 119,003 |
| Total AFS investments | - | 2,398,810 | 32,611 | - | 2,431,421 |
| Equity securities: | | | | | |
| Equity securities/REITs | 174,456 | - | - | 225,418 | 399,874 |
| Mutual fund bonds | - | 191,417 | - | - | 191,417 |
| Total equity securities | 174,456 | 191,417 | - | 225,418 | 591,291 |
| Cash equivalents including money market funds and short-term debt securities (***) | | | | | |
| | 16,680 | 300,675 | - | - | 317,355 |
| Total invested assets (**) | \$ 191,136 | \$ 2,890,902 | \$ 32,611 | \$ 225,418 | \$ 3,340,067 |
| Liabilities: | | | | | |
| Fair value of insurance and reinsurance contracts | | | | | |
| | - | - | 581,429 | - | 581,429 |
| Total liabilities | \$ - | \$ - | \$ 581,429 | \$ - | \$ 581,429 |

(*) 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 Level 2 securities.

Associated Electric & Gas Insurance Services Limited

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

| | December 31, 2019 | | | | |
|---|-------------------|--------------|------------|-------------------------------------|--------------|
| | Level 1 | Level 2 | Level 3 | Investments Valued at NAV (*) | Total |
| Assets: | | | | | |
| 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 |
| Liabilities: | | | | | |
| 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 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 Level 2 securities.

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 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 | | |
|---|-------------------------------------|---------------------|---------------------|----------------------------|------------------|------------------|
| | 2020 | 2019 | 2018 | 2020 | 2019 | 2018 |
| Balance, January 1 | \$ (532,628) | \$ (472,057) | \$ (460,399) | \$ 16,065 | \$ 22,256 | \$ 31,612 |
| Total (losses) gains realized/unrealized included in earnings | (45,684) | (59,873) | (1,630) | (884) | (185) | (257) |
| Issuances, purchases, and settlements: | | | | | | |
| Issuances | (38,365) | (41,467) | (37,475) | - | - | - |
| Purchases | 13,065 | 15,966 | 8,852 | 29,383 | - | - |
| Settlements | 22,183 | 24,803 | 18,595 | (11,953) | (6,006) | (9,099) |
| Balance, December 31 | <u>\$ (581,429)</u> | <u>\$ (532,628)</u> | <u>\$ (472,057)</u> | <u>\$ 32,611</u> | <u>\$ 16,065</u> | <u>\$ 22,256</u> |
| Changes in unrealized (losses) gains included in earnings related to obligations still held at reporting date | <u>\$ (45,684)</u> | <u>\$ (59,873)</u> | <u>\$ (1,630)</u> | <u>\$ (884)</u> | <u>\$ (185)</u> | <u>\$ (257)</u> |

Associated Electric & Gas Insurance Services Limited

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

The table below present's 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, 2020 | Valuation Technique | Unobservable Input | Selected Estimate |
|------------------------------------|-------------------------------------|--|----------------------|
| \$ 581,429 | Risk-adjusted discounted cash flows | Nominal net value of contracts | \$ 676,203 |
| | | Effective average discount rate ^(*) | 79.24 % |
| | | Risk margin ^(**) | 7.60 % |
| 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 ^(*) | 72.97 % |
| | | Risk margin ^(**) | 7.87 % |

(*) *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

Associated Electric & Gas Insurance Services Limited

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

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.

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:

| | 2020 | | | 2019 | | |
|---------------------|-----------------|------------|------------|-----------------|------------|------------|
| | Carrying Value* | Fair Value | % of Total | Carrying Value* | Fair Value | % of Total |
| Mortgage loans: | | | | | | |
| Commercial | \$ 121,167 | \$ 122,182 | 64.4 % | \$ 122,443 | \$ 123,655 | 61.7 % |
| Residential | 67,520 | 70,317 | 35.9 | 76,496 | 77,773 | 38.5 |
| Subtotal | 188,687 | 192,499 | 100.3 | 198,939 | 201,428 | 100.2 |
| Valuation allowance | (567) | - | (0.3) | (457) | - | (0.2) |
| Total, net | \$ 188,120 | \$ 192,499 | 100.0 % | \$ 198,482 | \$ 201,428 | 100.0 % |

*Carrying value before valuation allowance includes unearned loan commitment fees as of December 31, 2020 and 2019 of \$371 and \$497, respectively.

Purchases of mortgage loans were \$19,698 and \$53,846 for the years ended December 31, 2020 and 2019, respectively. 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, 2019 | \$ 227 | \$ 122 | \$ 349 |
| Provision 2019 | 117 | (9) | 108 |
| Balance at December 31, 2019 | 344 | 113 | 457 |
| Provision 2020 | 124 | (14) | 110 |
| Balance at December 31, 2020 | \$ 468 | \$ 99 | \$ 567 |

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 credit rating is downgraded or if the 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 valuation 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.

Associated Electric & Gas Insurance Services Limited

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

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 valuation allowance is established at loan origination. The amount of the valuation 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, 2020 and 2019. 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 | | | | |
| December 31, 2020 | Commercial | Residential | Total | | |
| Loan-to-value ratios: | | | | | |
| Less than 65% | \$ 31,489 | \$ 40,083 | \$ 71,572 | \$ 74,986 | 39.0% |
| 65% to 75% | 70,896 | 27,500 | 98,396 | 98,889 | 51.3 |
| 75% to 90% | 19,091 | - | 19,091 | 18,624 | 9.7 |
| Total | <u>\$ 121,476</u> | <u>\$ 67,583</u> | <u>\$ 189,059</u> | <u>\$ 192,499</u> | <u>100.0%</u> |

| | Cost | | | Total Estimated Fair Value | % of Total |
|--------------------------|------------------------------|--------------------|-------------------|---|-----------------------|
| | Debt Service Coverage | | | | |
| | Ratio > 1.2x | | | | |
| December 31, 2019 | Commercial | Residential | Total | | |
| 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 | <u>\$ 122,775</u> | <u>\$ 76,661</u> | <u>\$ 199,436</u> | <u>\$ 201,428</u> | <u>100.0%</u> |

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 underwriting capacity to 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 | |
|--|-----------------------|------------------|------------------|------------------|
| | 2020 | 2019 | 2020 | 2019 |
| Cash and cash equivalents | \$ 30 | \$ 240 | \$ 2,581 | \$ - |
| Investments | - | - | 32,611 | 16,065 |
| Accrued interest | - | - | 90 | 57 |
| Prepaid reinsurance premiums | 15,811 | 24,937 | - | - |
| Net deferred tax asset | - | - | 385 | 495 |
| | | | | |
| Total Assets of Consolidated VIEs | <u>\$ 15,841</u> | <u>\$ 25,177</u> | <u>\$ 35,667</u> | <u>\$ 16,617</u> |
| Due to reinsurers | \$ 19,934 | \$ 24,272 | \$ - | \$ - |
| Current income taxes payable | - | - | 1,988 | 1,972 |
| Accrued expenses and other liabilities | 22 | - | 142 | 142 |
| | | | | |
| Total Liabilities of Consolidated VIEs | <u>\$ 19,956</u> | <u>\$ 24,272</u> | <u>\$ 2,130</u> | <u>\$ 2,114</u> |

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, | | |
|-------------------|--------------------------|--------------|--------------|
| | 2020 | 2019 | 2018 |
| Written Premiums: | | | |
| Direct | \$ 2,077,833 | \$ 1,802,835 | \$ 1,552,367 |
| Assumed | 14,550 | 12,898 | 14,778 |
| Subtotal | 2,092,383 | 1,815,733 | 1,567,145 |
| Ceded | 769,832 | 658,945 | 539,124 |
| Net | \$ 1,322,551 | \$ 1,156,788 | \$ 1,028,021 |
| Earned Premiums: | | | |
| Direct | \$ 1,929,808 | \$ 1,645,195 | \$ 1,452,141 |
| Assumed | 13,510 | 14,693 | 12,654 |
| Subtotal | 1,943,318 | 1,659,888 | 1,464,795 |
| Ceded | 729,678 | 588,105 | 503,767 |
| Net | \$ 1,213,640 | \$ 1,071,783 | \$ 961,028 |

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, 2020 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, | | |
|--|--------------------------|-------------|-------------|
| | 2020 | 2019 | 2018 |
| Reserve for losses and loss expenses at January 1 | \$4,028,487 | \$3,659,832 | \$3,306,617 |
| Unpaid losses and loss expenses recoverable | (1,860,929) | (1,559,026) | (1,257,189) |
| Net reserve for losses and loss expenses at January 1 | 2,167,558 | 2,100,806 | 2,049,428 |
| Net incurred losses and loss expenses relating to losses occurring in: | | | |
| Current year | 850,491 | 724,751 | 604,995 |
| Prior years | (64,211) | 18,957 | (23,952) |
| Subtotal | 786,280 | 743,708 | 581,043 |
| Foreign exchange losses | 9,670 | 9,450 | 13,684 |
| Total net incurred losses and loss expenses | 795,950 | 753,158 | 594,727 |
| Net paid losses and loss expenses relating to losses occurring in: | | | |
| Current year | 103,196 | 116,120 | 94,621 |
| Prior years | 467,994 | 570,286 | 448,728 |
| Total net paid losses and loss expenses | 571,190 | 686,406 | 543,349 |
| Net reserve for losses and loss expenses at December 31 | 2,392,318 | 2,167,558 | 2,100,806 |
| Unpaid losses and loss expenses recoverable | 1,959,504 | 1,860,929 | 1,559,026 |
| Reserve for losses and loss expenses at December 31 | \$ 4,351,822 | \$4,028,487 | \$3,659,832 |

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

Changes in actuarial estimates of insured events in the prior years have resulted in a net increase (decrease) for the reserve for losses and loss expenses of \$(64,211), \$18,957 and \$(23,952) for the years ended December 31, 2020, 2019 and 2018, 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, | | |
|--|---------------------------------|------------------|--------------------|
| | 2020 | 2019 | 2018 |
| US - Excess Liability | \$ 14,106 | \$ 32,233 | \$ (12,896) |
| US - Property | (19,270) | (9,061) | (22,794) |
| US - Directors & Officers | (2,364) | (742) | 4,215 |
| Syndicate - Property | (54,853) | 2,081 | (1,353) |
| Syndicate - Casualty | 4,036 | (6,570) | (10,985) |
| Other | (5,866) | 1,016 | 19,861 |
| Total unfavorable/(favorable) prior year development | <u>\$ (64,211)</u> | <u>\$ 18,957</u> | <u>\$ (23,952)</u> |

Associated Electric & Gas Insurance Services Limited

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

The following describes the primary factors behind prior year reserve development for the years ended December 31, 2020, 2019 and 2018.

2020

| | |
|-----------------------|---|
| U.S.—Excess Liability | Unfavorable development driven by pollution exposures. |
| U.S.—Property | Attritional loss estimates have come in as expected, while catastrophe losses have been less than expected. |
| U.S.—D&O | Favorable development due to increased large claim activity. |
| Syndicate—Property | Favorable movement due to better than expected attritional claims experience following the recent hardening market. |
| Syndicate—Casualty | Small deterioration due to strengthening of prior year reserves in the Errors and Omissions line of business. |

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. |

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:

| | <u>2020</u> |
|--|---------------------|
| Net reserve for losses and loss expenses | |
| Presented in the loss development tables: | |
| US - Excess Liability | \$ 1,248,544 |
| US - Property | 91,171 |
| US - Directors & Officers | 140,185 |
| Syndicate - Property 2012-2020 | 297,636 |
| Syndicate - Casualty 2012-2020 | 416,345 |
| Syndicate - 2011 and prior | 30,008 |
| Other | 122,197 |
| Net reserve for losses and loss expenses | <u>\$ 2,346,086</u> |
| Ceded reserve for losses and loss expenses: | |
| US - Excess Liability | 1,124,924 |
| US - Property | 267,108 |
| US - Directors & Officers | 184,159 |
| Syndicate - Property 2012-2020 | 91,922 |
| Syndicate - Casualty 2012-2020 | 256,594 |
| Syndicate - 2011 and prior | 17,856 |
| Other | 16,941 |
| Ceded reserve for losses and loss expenses | <u>1,959,504</u> |
| Unallocated loss adjustment expenses | 46,232 |
| Reserve for losses and loss expenses | <u>\$ 4,351,822</u> |

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)

(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 incepted). 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

Associated Electric & Gas Insurance Services Limited

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

exposure to loss and is reliant on detailed loss information. A similar method, the ELR Method, estimates ultimate losses by applying 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.

Associated Electric & Gas Insurance Services Limited

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

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.

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.

Associated Electric & Gas Insurance Services Limited

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

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 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, 2020, 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, 2020 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 nine year tables ranging from 2012 to 2020.

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, 2020 |
|----------------------|-----------|------------|-----------|------------|------------|------------|------------|------------|------------|-------------|----------------------|
| | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | Net IBNR |
| Accident Year | | | | | | | | | | | |
| 2011 | \$225,302 | \$ 203,643 | \$162,268 | \$ 179,264 | \$ 173,739 | \$ 175,245 | \$ 186,408 | \$ 180,462 | \$ 187,271 | \$ 185,901 | \$ 2,678 |
| 2012 | | 232,136 | 226,959 | 222,697 | 235,610 | 237,266 | 244,146 | 244,617 | 228,207 | 210,097 | 4,006 |
| 2013 | | | 261,869 | 225,547 | 237,711 | 237,180 | 222,328 | 212,910 | 204,985 | 203,079 | 4,514 |
| 2014 | | | | 288,255 | 267,496 | 248,461 | 241,221 | 234,770 | 231,407 | 230,157 | 23,424 |
| 2015 | | | | | 290,683 | 281,842 | 224,200 | 186,862 | 198,939 | 181,363 | 33,639 |
| 2016 | | | | | | 267,526 | 252,525 | 242,817 | 232,333 | 234,631 | 15,015 |
| 2017 | | | | | | | 297,572 | 320,260 | 302,203 | 296,481 | 22,297 |
| 2018 | | | | | | | | 244,324 | 269,092 | 248,189 | 42,243 |
| 2019 | | | | | | | | | 266,175 | 326,890 | 70,829 |
| 2020 | | | | | | | | | | 302,867 | 256,292 |
| Total | | | | | | | | | | \$2,419,655 | |

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

| | | | | | | | | | | | Cumulative Number of Reported Claims |
|-------|----------|-----------|-----------|-----------|------------|------------|------------|------------|------------|--------------|---|
| 2011 | \$ 2,976 | \$ 24,488 | \$ 72,927 | \$ 98,295 | \$ 123,143 | \$ 142,836 | \$ 158,516 | \$ 164,454 | \$ 173,890 | \$ 174,357 | 147 |
| 2012 | | 157 | 39,572 | 79,632 | 107,992 | 138,308 | 174,178 | 179,526 | 193,139 | 196,332 | 144 |
| 2013 | | | 7,580 | 42,111 | 83,996 | 103,281 | 157,322 | 168,149 | 167,796 | 176,101 | 112 |
| 2014 | | | | 613 | 32,973 | 49,103 | 113,178 | 143,633 | 152,573 | 168,057 | 129 |
| 2015 | | | | | 240 | 73,733 | 95,177 | 102,695 | 122,034 | 109,742 | 108 |
| 2016 | | | | | | 260 | 39,646 | 83,876 | 174,838 | 175,165 | 99 |
| 2017 | | | | | | | 5,383 | 112,055 | 166,001 | 217,338 | 106 |
| 2018 | | | | | | | | 3,601 | 123,953 | 198,962 | 81 |
| 2019 | | | | | | | | | 150 | 37,490 | 59 |
| 2020 | | | | | | | | | | 10,432 | 46 |
| Total | | | | | | | | | | \$ 1,463,976 | |

All outstanding liabilities before 2011, net of reinsurance
Liabilities for losses and loss adjustment expenses, net of reinsurance

292,865
\$ 1,248,544

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,

| | Unaudited | | | | | | | | | | December 31, 2020 | |
|-----------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|-------------------|----------------------|--|
| | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | Net IBNR | |
| Accident | | | | | | | | | | | | |
| Year | | | | | | | | | | | | |
| 2011 | \$ 116,955 | \$ 113,990 | \$ 118,044 | \$ 112,505 | \$ 111,974 | \$ 111,283 | \$ 110,856 | \$ 110,828 | \$ 110,896 | \$ 110,912 | \$ - | |
| 2012 | | 58,248 | 85,152 | 101,760 | 76,531 | 74,086 | 73,482 | 73,181 | 73,243 | 73,244 | - | |
| 2013 | | | 41,011 | 30,566 | 29,252 | 27,900 | 27,390 | 27,385 | 27,390 | 27,422 | 34 | |
| 2014 | | | | 42,390 | 31,064 | 29,395 | 28,350 | 28,122 | 28,250 | 28,244 | 48 | |
| 2015 | | | | | 30,027 | 24,675 | 20,390 | 18,803 | 18,490 | 18,469 | 125 | |
| 2016 | | | | | | 32,304 | 26,190 | 22,759 | 20,829 | 20,272 | 430 | |
| 2017 | | | | | | | 36,721 | 21,001 | 18,516 | 18,890 | 626 | |
| 2018 | | | | | | | | 43,123 | 39,140 | 38,347 | 2,412 | |
| 2019 | | | | | | | | | 47,765 | 38,203 | 3,620 | |
| 2020 | | | | | | | | | | <u>72,102</u> | 25,408 | |
| Total | | | | | | | | | | <u>\$ 446,105</u> | | |

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

| | | | | | | | | | | | Cumulative Number of Reported Claims |
|-------|-----------|-----------|-----------|------------|------------|------------|------------|------------|------------|-------------------|---|
| 2011 | \$ 14,562 | \$ 59,776 | \$ 83,139 | \$ 107,651 | \$ 109,474 | \$ 111,028 | \$ 110,852 | \$ 110,888 | \$ 110,896 | \$ 110,912 | 145 |
| 2012 | | 13,509 | 37,181 | 49,225 | 64,652 | 73,081 | 73,260 | 73,244 | 73,244 | 73,244 | 128 |
| 2013 | | | 7,794 | 15,738 | 26,244 | 26,907 | 27,383 | 27,384 | 27,388 | 27,388 | 103 |
| 2014 | | | | 5,627 | 12,043 | 24,318 | 27,419 | 27,898 | 28,181 | 28,192 | 105 |
| 2015 | | | | | 4,270 | 10,196 | 14,331 | 17,356 | 17,374 | 18,055 | 119 |
| 2016 | | | | | | 4,446 | 13,665 | 18,168 | 19,029 | 19,516 | 120 |
| 2017 | | | | | | | 2,864 | 9,395 | 14,251 | 15,636 | 175 |
| 2018 | | | | | | | | 2,914 | 11,471 | 25,408 | 171 |
| 2019 | | | | | | | | | 6,124 | 23,779 | 173 |
| 2020 | | | | | | | | | | <u>12,810</u> | 218 |
| Total | | | | | | | | | | <u>\$ 354,940</u> | |

All outstanding liabilities before 2011, net of reinsurance
Liabilities for losses and loss adjustment expenses, net of reinsurance

6
\$ 91,171

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, 2020 |
|------------------|-----------|-----------|-----------|-----------|----------|----------|----------|----------|----------|------------|----------------------|
| | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | Net IBNR |
| 2011 | \$ 39,118 | \$ 34,449 | \$ 14,390 | \$ 11,231 | \$ 9,271 | \$ 8,337 | \$ 6,458 | \$ 6,468 | \$ 6,457 | \$ 6,457 | \$ - |
| 2012 | | 27,263 | 19,816 | 22,033 | 18,740 | 17,178 | 14,752 | 12,727 | 12,660 | 15,427 | 2,793 |
| 2013 | | | 28,592 | 31,914 | 28,226 | 26,234 | 25,212 | 17,222 | 19,812 | 24,087 | 4,365 |
| 2014 | | | | 38,054 | 31,498 | 23,596 | 18,216 | 12,696 | 17,031 | 17,657 | 248 |
| 2015 | | | | | 27,541 | 37,515 | 70,467 | 77,389 | 74,886 | 74,514 | 1,782 |
| 2016 | | | | | | 30,568 | 26,973 | 29,535 | 33,358 | 32,219 | 2,684 |
| 2017 | | | | | | | 40,148 | 51,948 | 48,454 | 41,877 | 3,988 |
| 2018 | | | | | | | | 20,718 | 15,857 | 23,288 | 8,727 |
| 2019 | | | | | | | | | 29,265 | 18,399 | 16,362 |
| 2020 | | | | | | | | | | 45,226 | 30,043 |
| Total | | | | | | | | | | \$ 299,151 | |

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

| Year | Unaudited | | | | | | | | | | Cumulative Number of Reported Claims | |
|-------|-----------|----------|----------|----------|----------|----------|----------|----------|----------|------------|---|----|
| | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | | |
| 2011 | \$ 1,358 | \$ 6,009 | \$ 6,186 | \$ 6,457 | \$ 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 | 10,429 | 11 |
| 2013 | | | 341 | 4,474 | 14,470 | 15,273 | 15,997 | 16,617 | 16,632 | 16,650 | 16,650 | 20 |
| 2014 | | | | 1,062 | 3,185 | 5,477 | 6,330 | 6,968 | 8,865 | 11,673 | 11,673 | 15 |
| 2015 | | | | | 33 | 11,295 | 22,514 | 32,407 | 62,498 | 74,620 | 74,620 | 18 |
| 2016 | | | | | | 1,549 | 11,031 | 14,078 | 14,083 | 14,429 | 14,429 | 20 |
| 2017 | | | | | | | 335 | 5,193 | 12,262 | 23,128 | 23,128 | 17 |
| 2018 | | | | | | | | 60 | 129 | 482 | 482 | 20 |
| 2019 | | | | | | | | | 56 | 773 | 773 | 17 |
| 2020 | | | | | | | | | | 91 | 91 | 12 |
| Total | | | | | | | | | | \$ 158,732 | | |

All outstanding liabilities before 2011, net of reinsurance
Liabilities for losses and loss adjustment expenses, net of reinsurance

(234)
\$ 140,185

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, 2020 for the U.S. reserve segments.

Average Annual Percentage Payout of Incurred Claims by Age, Net of Reinsurance

| Age in years | Year 1 | Year 2 | Year 3 | Year 4 | Year 5 | Year 6 | Year 7 | Year 8 | Year 9 | Year 10 |
|------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|---------|
| Excess liability | 1% | 24% | 19% | 18% | 13% | 6% | 4% | 5% | 3% | 0% |
| Property | 18% | 34% | 28% | 12% | 3% | 1% | 0% | 0% | 0% | 0% |
| D&O | 4% | 18% | 15% | 14% | 8% | 6% | 4% | 1% | 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

| Accident Year | Unaudited | | | | | | | | | December 31, 2020 |
|--|-----------|------------|-----------|-----------|-----------|-----------|-----------|-----------|--------------------|---|
| | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | Net IBNR |
| 2012 | \$162,311 | \$ 141,484 | \$138,114 | \$136,005 | \$137,489 | \$136,458 | \$136,175 | \$135,971 | \$136,910 | \$ (1) |
| 2013 | | 165,411 | 138,384 | 140,395 | 139,341 | 139,280 | 138,953 | 138,355 | 139,904 | 27 |
| 2014 | | | 179,416 | 163,527 | 164,255 | 157,044 | 158,147 | 160,576 | 159,525 | (99) |
| 2015 | | | | 160,929 | 131,136 | 133,519 | 132,433 | 130,603 | 130,432 | 223 |
| 2016 | | | | | 171,074 | 162,329 | 161,050 | 163,928 | 164,134 | 181 |
| 2017 | | | | | | 204,038 | 185,578 | 194,914 | 194,607 | 843 |
| 2018 | | | | | | | 209,582 | 199,003 | 198,703 | 7,679 |
| 2019 | | | | | | | | 238,891 | 198,015 | 8,027 |
| 2020 | | | | | | | | | 275,985 | 140,577 |
| Total | | | | | | | | | <u>\$1,598,215</u> | |
| | | | | | | | | | | Cumulative Number of Reported Claims |
| | | | | | | | | | | |
| Cumulative Paid Losses and Allocated Loss Adjustment Expenses, Net of Reinsurance | | | | | | | | | | |
| 2012 | \$48,860 | \$106,717 | \$121,554 | \$128,813 | \$130,841 | \$131,865 | \$132,717 | \$133,240 | \$134,762 | 6,045 |
| 2013 | | 56,389 | 108,021 | 126,538 | 133,225 | 136,045 | 136,984 | 137,842 | 138,876 | 6,230 |
| 2014 | | | 78,342 | 122,666 | 143,223 | 148,943 | 151,125 | 154,930 | 156,339 | 6,561 |
| 2015 | | | | 53,218 | 97,773 | 112,944 | 119,729 | 123,984 | 126,344 | 7,285 |
| 2016 | | | | | 78,666 | 130,386 | 145,166 | 151,531 | 155,948 | 8,187 |
| 2017 | | | | | | 78,084 | 142,688 | 167,901 | 178,367 | 9,278 |
| 2018 | | | | | | | 67,556 | 144,862 | 170,847 | 9,079 |
| 2019 | | | | | | | | 90,898 | 154,792 | 7,548 |
| 2020 | | | | | | | | | 84,304 | 4,948 |
| Total | | | | | | | | | <u>\$1,300,579</u> | |
| | | | | | | | | | | <u>\$297,636</u> |

Liabilities for losses and loss adjustment expenses, net of reinsurance (2012-2020)

\$297,636

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 | Unaudited | | | | | | | | | December 31, 2020 |
|---------------|-----------|-----------|-----------|-----------|-----------|----------|----------|----------|------------------|---|
| | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | Net IBNR |
| 2012 | \$ 93,489 | \$ 81,619 | \$ 65,016 | \$ 62,298 | \$56,768 | \$51,642 | \$50,347 | \$48,920 | \$45,637 | \$ (4,645) |
| 2013 | | 72,038 | 69,339 | 62,282 | 59,958 | 53,929 | 52,061 | 47,148 | 45,489 | (235) |
| 2014 | | | 89,160 | 83,926 | 76,019 | 71,491 | 69,330 | 64,476 | 63,847 | 1,258 |
| 2015 | | | | 82,123 | 88,991 | 77,988 | 73,137 | 71,887 | 66,492 | 1,750 |
| 2016 | | | | | 69,888 | 71,289 | 63,153 | 62,302 | 59,508 | 10,439 |
| 2017 | | | | | | 91,945 | 93,804 | 87,304 | 86,194 | 22,124 |
| 2018 | | | | | | | 105,571 | 103,537 | 107,567 | 41,651 |
| 2019 | | | | | | | | 117,235 | 137,400 | 85,568 |
| 2020 | | | | | | | | | 135,600 | 112,472 |
| Total | | | | | | | | | <u>\$747,734</u> | |
| | | | | | | | | | | Cumulative Number of Reported Claims |
| 2012 | \$ 6,982 | \$ 16,104 | \$ 25,582 | \$ 33,514 | \$ 36,254 | \$38,570 | \$41,831 | \$43,122 | \$45,240 | 1,956 |
| 2013 | | 1,932 | 6,377 | 18,240 | 23,137 | 28,265 | 32,881 | 36,590 | 38,055 | 2,822 |
| 2014 | | | 7,920 | 13,260 | 28,881 | 36,670 | 47,315 | 51,365 | 53,837 | 2,835 |
| 2015 | | | | 9,883 | 18,076 | 27,782 | 37,280 | 42,516 | 47,996 | 2,851 |
| 2016 | | | | | 3,615 | 11,802 | 20,150 | 28,467 | 36,585 | 3,300 |
| 2017 | | | | | | 9,312 | 16,664 | 27,405 | 40,515 | 3,566 |
| 2018 | | | | | | | 5,737 | 20,315 | 35,781 | 3,680 |
| 2019 | | | | | | | | 7,867 | 23,670 | 3,590 |
| 2020 | | | | | | | | | 9,710 | 1,758 |
| Total | | | | | | | | | <u>\$331,389</u> | |
| | | | | | | | | | | Liabilities for losses and loss adjustment expenses, net of reinsurance (2012-2020) |
| | | | | | | | | | <u>\$416,345</u> | |
| | | | | | | | | | | All outstanding liabilities before 2012, net of reinsurance |
| | | | | | | | | | <u>30,008</u> | |
| | | | | | | | | | | Liabilities for losses and loss adjustment expenses, net of reinsurance |
| | | | | | | | | | <u>\$743,989</u> | |

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, 2020 for the Syndicate business.

Average Annual Percentage Payout of Incurred Claims by Age, Net of Reinsurance

| Age in Years | Year 1 | Year 2 | Year 3 | Year 4 | Year 5 | Year 6 | Year 7 | Year 8 | Year 9 |
|--------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| Property | 40% | 35% | 12% | 5% | 2% | 1% | 1% | 1% | 1% |
| Casualty | 9% | 12% | 18% | 14% | 11% | 7% | 6% | 3% | 5% |

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, | | |
|---|--------------------------|---------------------|---------------------|
| | 2020 | 2019 | 2018 |
| Reinsurance recoverable on losses and loss expenses at January 1, | \$ 1,860,929 | \$ 1,559,026 | \$ 1,257,189 |
| Incurred losses and loss expenses ceded | 612,316 | 622,288 | 490,828 |
| Paid losses and loss expenses ceded | 514,812 | 322,396 | 191,695 |
| Effect of foreign exchange rate changes | 1,071 | 2,011 | 2,704 |
| Reinsurance recoverable on losses and loss expenses at December 31, | 1,959,504 | 1,860,929 | 1,559,026 |
| Amounts currently due from reinsurers | 148,841 | 82,277 | 34,859 |
| Due from reinsurers | <u>\$ 2,108,345</u> | <u>\$ 1,943,206</u> | <u>\$ 1,593,885</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, 2020 and 2019, 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, 2020 and 2019, such allowance was approximately \$32,686 and \$32,381, respectively. There were no write-offs of ceded losses for the years ended December 31, 2020 and 2019. As of December 31, 2020 and 2019, reinsurance recoverables overdue from reinsurers for 90 days or more, net of allowance, were \$3,832 and \$3,395, respectively.

At December 31, 2020 and 2019, 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 \$313,900 and \$365,093 at December 31, 2020 and 2019, respectively. The Company has reinsurance recoverables of \$299,983 and \$249,458, as of December 31, 2020 and 2019, respectively, from the second largest reinsurer which has an "A+" rating. The Company has reinsurance recoverables of \$229,194 and \$205,947, as of December 31, 2020 and 2019, respectively, from the third largest reinsurer which has an "A+" rating.

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:

| | 2020 | 2019 | 2018 |
|----------------------------|------------------|------------------|------------------|
| Current provision | \$ 33,855 | \$ 5,522 | \$ (11,535) |
| Deferred provision | (5,468) | 20,961 | 37,734 |
| Total income tax provision | <u>\$ 28,387</u> | <u>\$ 26,483</u> | <u>\$ 26,199</u> |

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

| | Tax Effect 2020 | Percent of Pre-Tax Income | Tax Effect 2019 | Percent of Pre-Tax Income | Tax Effect 2018 | Percent of Pre-Tax Income |
|---|--------------------------------|--|--------------------------------|--|--------------------------------|--|
| U.S. federal income tax at statutory rate | \$29,537 | 21.0% | \$ 30,328 | 21.0% | \$ 26,523 | 21.0% |
| Adjustments: | | | | | | |
| Change in valuation allowance | - | - | - | - | (1,237) | (1.0) |
| Company-owned officers' life insurance | (2,132) | (1.5) | (2,661) | (1.8) | 616 | 0.5 |
| Return-to-provision adjustments | 905 | 0.6 | (573) | (0.4) | 840 | 0.6 |
| Other permanent items | 77 | 0.1 | (611) | (0.5) | (543) | (0.4) |
| Total income tax provision | <u>\$28,387</u> | <u>20.2%</u> | <u>\$ 26,483</u> | <u>18.3%</u> | <u>\$ 26,199</u> | <u>20.7%</u> |

On March 27, 2020, the Coronavirus Aid, Relief and Economic Security Act (CARES Act) was signed into law. The Company has considered all potential tax impacts of the CARES Act and has determined that the law had an immaterial impact on the total income tax provision.

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:

| | 2020 | 2019 |
|---|-----------|-----------|
| Deferred tax assets: | | |
| Loss reserves | \$ 45,121 | \$ 40,834 |
| Net operating loss carryforwards | 2,222 | 1,715 |
| Unearned premiums | 23,099 | 19,117 |
| Alternative minimum tax credits | - | 3,842 |
| Anticipatory foreign tax credit | 4,911 | 423 |
| Profit commission and other accruals | 14,102 | 10,441 |
| Compensation and benefit accruals | 21,488 | 23,235 |
| Syndicate technical account | - | 1,872 |
| Other deferred tax assets | 1,362 | 1,337 |
| Gross deferred tax assets | 112,305 | 102,816 |
| Less valuation allowance | - | - |
| Deferred tax assets | 112,305 | 102,816 |
| Deferred tax liabilities: | | |
| Unrealized investment gains on securities—net | 11,009 | 10,255 |
| Change in fair value of insurance and reinsurance contracts | 19,903 | 28,820 |
| Fixed asset basis difference | 639 | 683 |
| Deferred acquisition costs | 6,348 | 6,820 |
| TCJA transition adjustment | 3,793 | 4,551 |
| Claims equalization reserve | 2,200 | 3,792 |
| Basis difference in investments | 4,242 | 908 |
| Syndicate technical account | 12,257 | - |
| Deferred tax liabilities | 60,391 | 55,829 |
| Net deferred tax asset | \$ 51,914 | \$ 46,987 |

The Company has \$2,222 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 2040. The Company has utilized all of its alternative minimum tax and foreign tax credits.

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 2009-2014 tax years with respect to foreign tax credits. The 2016-2019 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 2016 U.S. consolidated tax return. No adjustments have been proposed to date.

At December 31, 2020 and 2019, 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)

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 2032. Rent expense is recorded in other underwriting expenses in the consolidated statement of income and for the years ended December 31, 2020, 2019 and 2018 was \$5,822, \$4,910 and \$4,666, respectively.

The Company's aggregate minimum rental commitments as of December 31, 2020 are as follows:

| Year | Amount |
|-----------------------------|------------------|
| 2021 | \$ 4,220 |
| 2022 | 4,159 |
| 2023 | 3,724 |
| 2024 | 3,758 |
| 2025 | 3,793 |
| Years thereafter until 2032 | 11,535 |
| Total | <u>\$ 31,189</u> |

On April 15, 2020, AEGIS Managing Agency Limited ("AMAL"), a subsidiary of AEGIS London Holding, entered into a lease agreement to lease office space for its new London corporate offices. The previous lease expired in 2020. The new lease term began on July 1, 2020 and runs through March 25, 2032.

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, 2020 and 2019, the Company's limited partnership investments had unfunded direct lending commitments totaling \$157,989 and \$91,022, respectively.

Associated Electric & Gas Insurance Services Limited

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

As of December 31, 2020 and 2019, the Company's mortgage loan investments had unfunded commitments totaling \$5,349 and \$5,064, respectively.

As of December 31, 2020 and 2019, the Company's REIT investments had unfunded commitments totaling \$0 and \$20,000, respectively.

Securities on Deposit and Letters of Credit

At December 31, 2020, the Company had securities and cash on deposit of \$937,954 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 \$443,578, of which \$380,212 was committed at December 31, 2020. At December 31, 2020, the Company had pledged assets of cash and debt securities, valued at \$643,147, as collateral to secure these letters of credit.

12. Dividend Restrictions

No dividend transfers occurred in 2020 and 2019. At December 31, 2020 and 2019, there were no significant restrictions on the payment of dividends from AISL to AEGIS London Holding.

In 2020, there was a transfer of capital of \$40 million from AEGIS to AEGIS London Holding which in turn transferred the \$40 million to AISL.

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, 2020 through the consolidated financial statements issuance date of April 2, 2021, there are no events to disclose.

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 \$379 million for solvency and liquidity. As a Class 3 insurer, the policyholders' surplus at December 31, 2020 was in excess of the minimum solvency margin required.

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. 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 | | |
|---|-------------------|-------------------|-------------------|--------------------------------|---------------------|---------------------|---------------------|---------------------|---------------------|
| | 2020 | 2019 | 2018 | 2020 | 2019 | 2018 | 2020 | 2019 | 2018 |
| Revenue: | | | | | | | | | |
| Net premiums earned | \$ 930,507 | \$ 816,577 | \$ 737,288 | \$ 283,133 | \$ 255,206 | \$ 223,740 | \$ 1,213,640 | \$ 1,071,783 | \$ 961,028 |
| Net investment income | 78,514 | 150,991 | 40,054 | 34,485 | 67,990 | 18,019 | 112,999 | 218,981 | 58,073 |
| Change in fair value of insurance and reinsurance contracts | (45,684) | (59,873) | (1,630) | - | - | - | (45,684) | (59,873) | (1,630) |
| Total revenue | <u>963,337</u> | <u>907,695</u> | <u>775,712</u> | <u>317,618</u> | <u>323,196</u> | <u>241,759</u> | <u>1,280,955</u> | <u>1,230,891</u> | <u>1,017,471</u> |
| Expenses: | | | | | | | | | |
| Losses and loss expenses incurred | 622,936 | 596,036 | 469,982 | 173,014 | 157,122 | 124,745 | 795,950 | 753,158 | 594,727 |
| Commission expenses | 103,074 | 94,237 | 84,294 | 46,809 | 42,801 | 38,046 | 149,883 | 137,038 | 122,340 |
| Other underwriting expenses | 95,077 | 100,909 | 95,418 | 36,045 | 36,551 | 33,971 | 131,122 | 137,460 | 129,389 |
| Total expenses | <u>821,087</u> | <u>791,182</u> | <u>649,694</u> | <u>255,868</u> | <u>236,474</u> | <u>196,762</u> | <u>1,076,955</u> | <u>1,027,656</u> | <u>846,456</u> |
| Income before continuity and other premium credits and income taxes | 142,250 | 116,513 | 126,018 | 61,750 | 86,722 | 44,997 | 204,000 | 203,235 | 171,015 |
| Continuity and other premium credits | <u>30,210</u> | <u>25,237</u> | <u>14,953</u> | <u>33,136</u> | <u>33,580</u> | <u>29,756</u> | <u>63,346</u> | <u>58,817</u> | <u>44,709</u> |
| Income before income taxes | 112,040 | 91,276 | 111,065 | 28,614 | 53,142 | 15,241 | 140,654 | 144,418 | 126,306 |
| Income tax provision | <u>22,612</u> | <u>16,737</u> | <u>23,037</u> | <u>5,775</u> | <u>9,746</u> | <u>3,162</u> | <u>28,387</u> | <u>26,483</u> | <u>26,199</u> |
| Net income | 89,428 | 74,539 | 88,028 | 22,839 | 43,396 | 12,079 | 112,267 | 117,935 | 100,107 |
| Other comprehensive (loss) income | 1,923 | 25,049 | (16,598) | 911 | 3,441 | (4,646) | 2,834 | 28,490 | (21,244) |
| Other surplus adjustments | 2,580 | - | - | - | - | - | 2,580 | - | - |
| Total surplus—beginning 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> |
| Total surplus—end of year | <u>\$ 804,400</u> | <u>\$ 710,469</u> | <u>\$ 610,881</u> | <u>\$ 1,095,834</u> | <u>\$ 1,072,084</u> | <u>\$ 1,025,247</u> | <u>\$ 1,900,234</u> | <u>\$ 1,782,553</u> | <u>\$ 1,636,128</u> |