



# Catlin Insurance Company Ltd

AN XL GROUP LTD COMPANY

## Financial Condition Report ("FCR")

**31 December 2016**

forming part of the annual regulatory reporting package  
submitted to the Bermuda Monetary Authority ("BMA") by 30 June 2017

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## Summary

Catlin Insurance Company Ltd. ("Catlin Bermuda" or the "Company") is a Bermuda insurer incorporated on December 18, 2000 under the laws of Bermuda. The Company is a wholly owned subsidiary of Green Holdings Ltd ("the parent") a Bermuda licensed holding company. The Company together with its subsidiaries, writes insurance and reinsurance on a global basis.

### A. Business and Performance

This section provides particulars regarding the organisational structure, insurance business activities and financial performance.

#### A.1. Name of insurer

Catlin Insurance Company Ltd

#### A.2. Supervisors

	Insurance Supervisor	Group Supervisor
Name:	Bermuda Monetary Authority, BMA House, 43 Victoria Street, Hamilton HM 12 Bermuda	Bermuda Monetary Authority, BMA House, 43 Victoria Street, Hamilton HM 12 Bermuda
Jurisdiction:	Bermuda	Bermuda
Email Address:	info@bma.bm	info@bma.bm
Phone Number:	441-295-5278	441-295-5278

#### A.3. Approved auditor

Organisation:	PricewaterhouseCoopers Dorchester House, 7 Church Street West, Hamilton, HM11 Bermuda
Name:	Matthew Britten
Jurisdiction:	Bermuda
Email Address:	m.britten@bm.pwc.com
Phone Number:	441-299-7265

#### A.4. Ownership details

Owner Name	Ownership Percentage
Green Holdings Ltd	100.00%

## A.5. Group structure

See [Appendix 01 – XL Group Ltd Structure Chart 2016 Q4](#)

## A.6. Insurance business written by business segment and by geographical region

The following tables summarize the consolidated Company's gross premium written and net premiums written by line of business for the year ended December 31, 2016:

	<b>Gross Premium Written</b>	<b>Net Premium Written</b>
	<b>USD '000</b>	<b>USD '000</b>
Property Catastrophe	1,028,372	861,607
Property	1,735,329	686,394
Property Non – Proportional	106,683	84,173
Personal Accident	324,916	290,786
Personal Accident Non- Proportional	507	684
Aviation	100,879	6,705
Aviation Non – Proportional	251,845	251,808
Credit / Surety	525,913	429,425
Credit / Surety Non – Proportional	18,358	18,183
Energy Offshore / Marine	476,746	377,723
Energy Offshore / Marine Non - Proportional	250,144	247,986
US Casualty	375,685	367,359
US Casualty Non - Proportional	19	23
US Professional	479,951	479,929
US Professional Non – Proportional	(2)	(2)
International Motor	94,719	87,850
International Motor Non – Proportional	5,530	5,478
International Casualty Non – Motor	933,634	639,959
International Casualty Non Motor Non – Proportional	425,789	423,172
Health	25,298	16,935
<b>Total</b>	<b>7,160,315</b>	<b>5,276,177</b>

The following table shows an analysis of the consolidated Company's net premiums written by geographical location of the subsidiary where the premium is written for the year ended December 31, 2016:

<b>Geographical Location</b>	<b>Geographical Location</b>
	<b>USD \$'000</b>
Central & Western Asia	78,526
Eastern Asia	351,229
South and South-Eastern Asia	156,775
Oceania	398,519
Northern Africa	24,780
Southern Africa	94,357
Eastern Europe	42,164
Northern Europe	738,036
Southern Europe	199,717
Western Europe	243,563
Northern America (Excluding USA)	391,093
Caribbean & Central America	115,695
Eastern South America	53,478
Northern, Southern and Western South America	107,878
North-East United States	255,563
South-East United States	1,417,008
Mid-West United States	18,412
Western United States	589,384
	5,276,177

## A.7. Performance of investments and material income and expenses for the reporting period

The following table shows the fair market value of the fixed maturity portfolio (both quoted and unquoted) along with the gross redemption yields at year end 2016, split by type of investment.

	Market Value	Average YTM
	\$'000	%
U.S. Government		
(a) U.S. Government Federal	744,252	1.49%
(b) U.S. Government Agency - mortgage-backed securities	939,916	1.66%
(c) U.S. Government Agency - other	666,574	2.23%
Non-U.S. Government	1,338,081	1.93%
States, Municipalities, and Political Subdivision	601,678	2.76%
Corporate Securities		
(a) U.S. Government-backed Corporate	—	—%
(b) Non-U.S. Government-backed Corporate	—	—%
(c) FDIC Guaranteed Corporate	—	—%
(d) Other Corporate	2,151,484	2.26%
Asset-backed Securities	487,289	1.62%
Mortgage-backed Securities		
(a) Residential Subprime	46	4.11%
(b) Residential Non-subprime	12,858	1.80%
(c) Commercial	118,565	2.79%
<b>TOTAL PORTFOLIO</b>	<b>7,060,743</b>	

The consolidated Company's main revenue is premiums and its major expenses arise from claims losses.

<i>(U.S. dollars in thousands)</i>	<b>2016</b>
<b>Income</b>	
Earned Premium	4,520,528
<b>Expenses</b>	
Net losses and loss expenses incurred - P&C operations	2,719,760
Acquisition costs	1,309,887
Operating expenses	548,829
<b>Total Expenses</b>	<b>4,578,476</b>



## A.8. Other material information

For the year ended December 31, 2106, there is no other information relating to business and performance required to be disclosed for purposes of this Financial Condition Report.

## B. Governance Structure

This section provides particulars of corporate governance, risk management and solvency self-assessment frameworks.

### B.1. Board and Senior Executive

#### B.1.1. Structure of the Board and senior executive, roles, responsibilities and segregation of responsibilities

##### i. Directors

The Board of Directors of the Company (the "Board") oversees the effective management of the Company's business and affairs and is responsible for the maintenance of an effective corporate governance framework. The Board is elected annually and consists of the following executive directors each of whom is a senior executive of the Company or XL Group Ltd ("XL", "XL Group", or "Group"):

	Directors
(1)	Charles Cooper
(2)	*Claudette Hodgson
(3)	*Jonathan Gale
(4)	Mark Twite
(5)	Andrew MacFarlane

**\*Note:** (i) Jonathan Gale and Claudette Hodgson were appointed directors on March 31, 2017.

(ii) Stephen Catlin resigned as a director of the Company effective Jun 23, 2017.

##### Senior Executives

The Company's senior executives assist the Board with its oversight responsibilities by its reporting to the Board on the Company's business activities. The senior executives also make recommendations to the Board regarding, and are responsible for, the execution of the Company's strategic plans and objectives. The senior executives are responsible for the respective functions which they head and for ensuring the necessary resources, systems and controls required for the effective execution of the roles and responsibilities of those functions.

<b>Senior Executive</b>
*Jonathan Gale - Chief Executive Reinsurance
*Claudette Hodgson - Chief Financial Officer, Reinsurance
Andrew MacFarlane - Chief Actuary, Bermuda
Stephen Smith - Head of Reinsurance Claims
Malcolm Furbert - General Counsel and Head of Compliance & Regulatory Affairs Bermuda
Lisa Robinson - HR Business Partner, Bermuda, Bermuda Reinsurance & Global Reinsurance Operations

**\*Note:**

(i) As of January 10, 2017 Charles Cooper ceased to be Chief Executive, Reinsurance and was appointed Chief Executive, (worldwide) Reinsurance and Jonathan Gale was appointed Chief Executive, (Bermuda) Reinsurance.

(ii) As of April 1, 2017 Mark Twite ceased to be Chief Financial Officer of the Company and Claudette Hodgson was appointed as Chief Financial Officer.

## **B.1.2. Remuneration policy**

### **Director Compensation**

The directors are not separately compensated for their Board roles.

### **Executive Compensation**

Catlin Insurance Company Ltd adheres to the XL Group remuneration policy.

XL Group's remuneration program is designed to ensure strong alignment between executive pay and company and individual performance by including both short-term and long-term incentives that motivate executives to achieve our near-term goals and longer-term strategic objectives. The design of these programs is guided by the following principles:

- Ensure alignment with shareholder interests and reward executives for enhancing long-term shareholder value
- Consider multiple factors in setting target levels of compensation, including an executive's role and responsibilities, performance, experience, expertise and competitor compensation information
- Allocate total compensation among annual base salary, annual cash incentive and long-term incentive awards so that it is heavily weighted towards performance-based pay
- Enable the attraction and retention of high caliber executive talent who will develop and successfully implement our business strategy
- Include qualitative components and strong governance practices that mitigate risk and drive appropriate behaviors

The balance of fixed and variable compensation is consistent with competitive market practice in the insurance industry, while permitting XL Group to operate fully flexible variable compensation policies. Variable pay for colleagues in independent control functions is not aligned with the performance of

the businesses they oversee, and is designed to avoid conflicts of interest while appropriately balancing risk and reward. Remuneration for executives is comprised generally of three components:

- **Fixed Remuneration** - We consider multiple factors - including an individual's role and responsibilities, performance, experience, expertise and peer market compensation information in setting target levels of base compensation.
- **Variable Remuneration** - Individual bonus awards are determined based on performance reviews of individual and the Group's performance and are fully discretionary, allowing for full flexibility to award no variable remuneration if warranted. Staff have a bonus target amount expressed as a percentage of base pay.
- **Long-Term Incentive Plan** Long-term incentive awards are reserved for those who perform at a high level, recognize the recipient's anticipated future contributions, and take relative and absolute performance, individual potential and unique skills into consideration. Grants of long-term incentives are based on sustained individual performance and criticality of skills. For our most senior leaders, shares awarded under our long-term incentive program are subject to mandatory holding periods and minimum ownership requirements. Individual awards under the Company's long-term incentive plans are also capped.

XL Group believes that it is important to review its incentive programs to ensure that the programs are operating as intended, have appropriate oversight, and motivate desired colleague behaviours. As a result, XL Group performs an annual assessment of the potential risks associated with its compensation policies and practices to ensure that its compensation programs do not encourage undue risk taking.

This review is performed by a cross-functional risk review team, and the results are presented to XL Group Ltd's Management Development and Compensation Committee of the Board of Directors ("MDCC"). Among its responsibilities, the MDCC is responsible for reviewing and approving the overall compensation structure of XL Group.

### **B.1.3. Pension or early retirement schemes for members, board and senior employees**

The Company's remuneration program does not include any supplementary pension or early retirement schemes for its non-Executive Directors or its senior executives.

### **B.1.4. Shareholder controllers, persons who exercise significant influence, the board or senior executive material transactions**

Since September 1, 2015, Mr. Catlin, a director of the Company until June 23, 2017, has paid the Company for use of a Bermuda residence (purchased by the Company in May 2014, prior to the XL Group's acquisition of the Catlin Group) at a fair market value rate of \$25,000 per month. The fair market rental value of the residence was determined by an independent real estate appraiser taking into account, among other factors, the availability of this property for corporate functions and other corporate use. Mr. Catlin paid \$300,000 under these arrangements during 2016.

Except for the foregoing and other than dividends paid to the Company's preference shareholders during the year ended December 31, 2016, the Company is not aware of any other material transactions required to be disclosed for purposes of this financial condition report.

## **B.2. Fitness and Propriety Requirements**

### **B.2.1. Fit and proper process in assessing the board and senior executive**

#### **Board of Directors: Fit and Proper Assessment**

The process for assessing the skills and characteristics for new board candidates, and for the Board as a whole on an annual basis, will include consideration of the following criteria:

- Personal qualities and characteristics, including business judgement, integrity, high standards of ethical conduct and distinction in their chosen fields of endeavour;
- Current knowledge of and experience in the areas of insurance, reinsurance, financial services or other aspects of Catlin Insurance Company Ltd's business, operations or activities;
- Diversity of viewpoints, skills, experience and other demographics in the context of the needs of the Board; and
- Such other attributes and external factors deemed appropriate.

### **Executive: Fit and Proper Assessment**

The fit and proper assessment, of a person shall include:

- an assessment of that person's professional and formal qualifications, knowledge and relevant experience within the insurance sector, other financial sectors or other businesses and shall take into account the respective duties allocated to that person and, where relevant, the insurance, financial, accounting, actuarial and management skills of the person;
- an assessment of that person's honesty and financial soundness based on evidence regarding their character, personal behaviour and business conduct including any criminal, financial and supervisory aspects relevant for the purposes of the assessment.

Additionally, the Company maintains a standard recruitment process to assist in the assessment of whether candidates for executive positions are fit and proper. The recruitment process includes (i) ensuring that job specifications adequately reflect the position being recruited and appropriately identifies the necessary skills and qualifications required for the position, (ii) contacting local recruitment agencies/executive search firms and establishing broad and informal panels of agencies for particular areas of expertise to ensure that the most appropriate matching can take place, and (iii) undertaking, on an outsourced basis, a series of checks in relation to the candidate after the offer has been communicated to them and the satisfactory completion of detailed relevant background checks.

## **B.2.2. Board and senior executives' professional qualifications, skills, and expertise**

### **Board of Directors**

**Charles Cooper:** As of 1 January 2017, Mr. Cooper became Chief Executive of XL's worldwide Reinsurance Operations and joined the Group's Leadership Team and has 17 years of experience in the reinsurance industry. He is also part of XL Group's Managing Director leadership team. During his employment with the XL Group (from 2000 to 2005 and 2010 to present), Mr. Cooper has held progressively senior underwriting roles. Previously, he was Executive Vice President and Head of North American Property Catastrophe Reinsurance Underwriting at Validus Reinsurance Ltd.

**Claudette Hodgson:** Claudette Hodgson is currently CFO, Bermuda Reinsurance and has 14 years of experience working in the (Re)Insurance industry. Prior to joining XL, she was Financial Controller for Catlin Insurance Company Ltd. Prior to joining Catlin Insurance Company Ltd, Claudette worked at ACE Bermuda. Claudette is a Certified Public Accountant and qualified from PricewaterhouseCoopers in 2003. Claudette holds a Bachelor of Commerce from Dalhousie University and is a member of the Institute of Chartered Accountants Bermuda.

**Jonathan Gale:** Mr. Gale is Chief Executive, Bermuda Reinsurance for the XL group of companies. When the XL Group acquired the Catlin Group in July 2015, Mr. Gale was installed as Chief Executive, Reinsurance London and Joint Active Underwriter of Syndicate 2003, the largest Syndicate at Lloyd's. During his career he worked for in the US broker market and spent almost five years in the Bermuda market running Catlin's nascent Bermudian underwriting business from 2003 to 2008. The majority of his career has been in the Lloyd's market having started in the London and Lloyd's market in 1987 specialising in US medical malpractice and in particular reinsurance of PIAA companies and specialist Risk Retention Groups.

**Mark Twite:** Mr. Twite is currently XL Group Ltd's Head of Reinsurance Finance and has 19 years of experience working in the (Re)Insurance industry. Immediately prior to his current role Mark was CFO, Bermuda Reinsurance and has held progressively senior Finance roles during his 13 years with XL. Prior to joining XL, Mark was the Financial Controller of Liberty Syndicates (the Lloyd's of London operation of the Liberty Mutual Group). Mark is a fellow

of the Institute of Chartered accountants in England and Wales and qualified from Deloitte & Touche in 1998 while working in their London Insurance practice. Mark holds a B.S. in Economics from the London school of Economics (LSE).

Andrew MacFarlane: Andrew MacFarlane: Mr. MacFarlane is currently Chief Actuary, Bermuda Reinsurance and has 15 years of experience working in the (Re)Insurance industry. Mr. Mac Farlane worked at Equitas in London before moving to Catlin Syndicate in 2004. He moved to Bermuda in 2008 where he was the Business Actuary at Catlin Insurance Company Limited for 7 years before Catlin Group was acquired by XL Group, following which he was promoted to his current position. Mr. MacFarlane is a Fellow of the Institute and Faculty of Actuaries in the UK and graduated from the University of the Witwatersrand in South Africa with a Honours Degree in Actuarial Science and Statistics.

### **Senior Executive**

For Claudette Hodgson see above.

For Jonathan Gale see above.

For Andrew MacFarlane see above.

Stephen Smith: Stephen joined XL Re Ltd (formally Mid Ocean Re) in January 1994. In January 2001 he was promoted to AVP Claims Manager and in April 2002 to VP Claims Manager. Prior to joining XL, Stephen was the Claims Manager for Johnson & Higgins (now Marsh IAS Management Services) where he, along with a small team, managed the claims activities for in excess of 100 captive companies. For two years prior to departing J&H, Stephen also managed the claims run-off of five NY Insurance Exchange syndicates. Stephen has in excess of 30 years' experience working in the Insurance/Reinsurance industry, of which the last 19 have been with XL Re.

Malcolm Furbert: Mr. Furbert is General Counsel and Head of Compliance & Regulatory Affairs, Bermuda. Prior to joining XL, he was General Counsel for the Catlin Group's Bermuda operations. Prior to joining the Catlin Group, Mr. Furbert worked as a corporate lawyer with one of Bermuda's leading law firms and held various general counsel positions with Bermuda-based reinsurance companies. He holds a B.A. in Economics from Dalhousie University, an LLB (Hons) from Bristol University and is a member of the Bar of England and Wales and the Bermuda Bar.

Lisa Robinson: Ms. Robinson is the HR Business Partner for Bermuda, Reinsurance Bermuda and Global Reinsurance Operations at XL. Prior to assuming her role at XL she held the position of Head of Human Resources for Catlin Insurance Company Ltd. and the HR Business Partner for Global Human Resources across the Catlin Group. Ms. Robinson has over 15 years of Human Resources experience, with over 10 years in an executive role. She holds a Professional in Human Resources (PHR) designation from the HR Certification Institute, a Human Resources Studies Certificate from Cornell University and is a Certified Human Resources Professional (SHRM-CP) with the Society for Human Resource Management. Ms. Robinson is also a Certified Herrmann Brain Dominance Instrument Practitioner.

## **B.3. Risk Management and Solvency Self-Assessment**

### **B.3.1. Risk management process and procedures to effectively identify, measure, manage and report on risk exposures**

The Company faces strategic, financial and operational risks related to, among others: underwriting activities, financial reporting, changing macroeconomic conditions, investment, reserving, changes in laws or regulations, information systems, business interruption and fraud. An enterprise view of risk is required to identify and manage the consequences of these common risks and risk drivers on our profitability, capital strength and liquidity which is managed by the Enterprise Risk Management (ERM) function who implement the Risk Management Framework ("RMF").

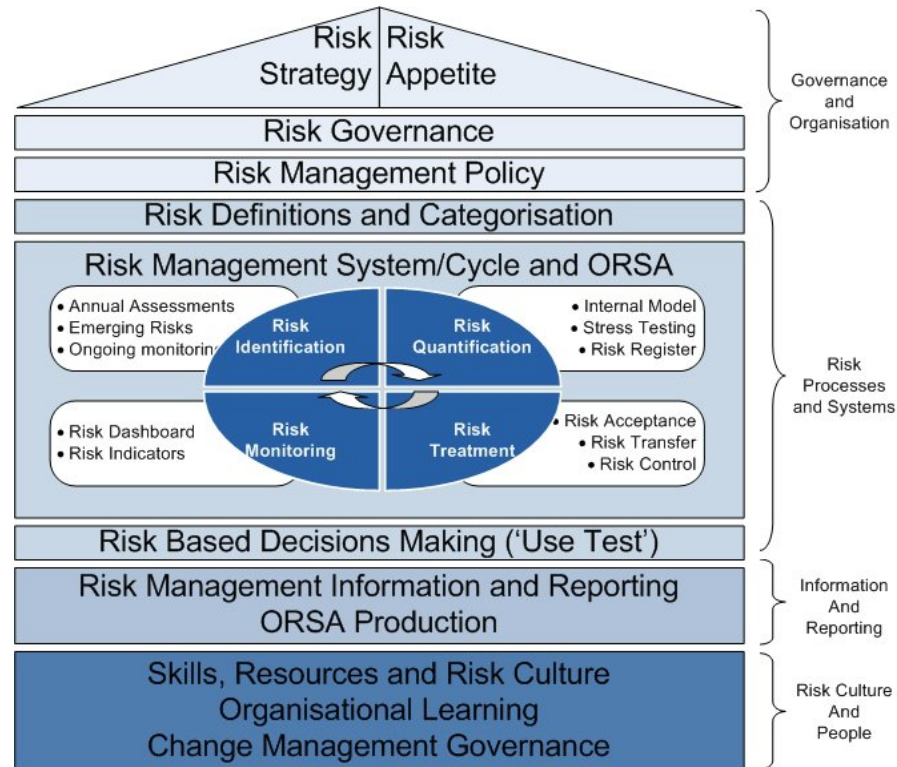
The Company adopts the XL Group Ltd's (the "Group") RMF which is reviewed and approved by the Board, at least annually. The RMF would be reviewed more regularly if the Company was subject to a major change in regulatory requirements, strategy or organisational structure. The aim of the RMF is to:

- Support business objectives and strategy;

- Provide management information to facilitate the identification and understanding of material risks including related mitigants;
- Contribute to the Company's overall internal control framework by helping to manage the inherent complexity within the business;
- Improve the Group's ERM rating and credit rating which is applicable to the Company;
- Support regulatory risk management requirements.

The Board meets regularly and oversees the implementation and embedding of the RMF and monitoring of Company performance. The Board also has responsibility for capital monitoring. The Board ensures that material and emerging risks are identified and reported and that appropriate arrangements are in place to manage and mitigate those risks effectively. The Company's stress testing framework and outputs are reviewed by the Board and support understanding of the risk profile.

The RMF comprises the following:



Please note that the term ORSA is used to describe the CISSA above

### **Risk Management Strategy**

The risk management strategy is overseen by the Board and supports the delivery of the overall business strategy. To support the Board, the ERM function oversees more detailed risk management activity and the Board approved risk appetites.

The risk management strategy is to ensure that risk is considered alongside reward in setting the Company's strategic and business objectives. The strategy is articulated in the RMF and risk policies and is achieved by incorporating risk processes, information and decisions in the day to day running of the business.

The Company's strategy involves taking on risk in order to generate return. Risks are selected and controlled or traded off through the risk strategy that focuses on:

- Retaining risk within an approved risk appetite that is consistent with our strategic objectives, with appropriate levels of capital with excess held by the Company;
- A diversified portfolio of underwriting and financial markets risks;
- Managing excessive aggregation risk via a limit framework;
- Exercising consistency and transparency of risk management and control across the Company;
- Risk mitigation on key underwriting and financial market risks to protect capital from the impact of extreme events; and
- Risk reporting to the Board and other stakeholders (e.g. regulators).

### ***Risk Appetite Framework (RAF)***

The Company's Risk Appetite Framework (RAF) provides governance for setting new monitoring requirements as well as reviewing and updating existing risk appetite statements, tolerances and limits so that these are aligned with business and risk management strategies. The Company's RAF focuses on regulatory capital at risk, tolerances to risks from material individual events, liquidity standards, tolerance to specific investment related risks and operational loss. The Board approved risk appetites and risk tolerances were reviewed during the 2017 business planning process and it was determined that all existing statements and tolerances were appropriate to allow the Company to execute the 2017 business plan.

"Risk appetites," as referred to above, are broad statements used to guide the Company's risk and reward preferences over time, all consistent with, among other factors, business prudence, market opportunities, the underwriting pricing cycle and investment climate.

The risk strategy and risk appetite frameworks are supported by the following:

- **Risk Governance** sets out a clear and cost effective organisational structure for risk management, including clear roles and responsibilities.
- **Risk Policies** document the Company's approach to the management of each category of risk to which the Company is exposed.
- **Risk definition and categorisation** provides a common taxonomy and language for risk to allow for categorisation of all risks in a way which facilitates links between the business and risk management processes.
- **Risk cycle and processes** are the approach taken to top down, bottom up and process led risk identification, quantification and management and control.
- **Risk Management Information and Reporting, including CISSA Production** ensuring timely and accurate information is reviewed in line with the governance structure.
- **Skills, Resources and Risk Culture. Organisational Learning. Change Management Governance** - All enable a mature risk culture throughout the Company.

### ***Risk Reporting***

A risk dashboard is presented on a regular basis to the Board. The dashboard measures the status against risk appetite statements and the associated monitoring triggers and limits using the latest output from the business and the Bermuda Solvency Capital Requirement ("BSCR"). Highlights from the dashboard including performance against appetite and limits are reported to the Board.

### **B.3.2. Risk management and solvency self-assessment systems implementation**

The Company benefits from the Group's overall ERM framework which includes a Group ORSA assessment process. The Group ORSA incorporates outputs from the Group Internal Model and is produced in accordance with the Group ORSA Policy. As such, in addition to this standalone assessment, the Company's business and operations are also incorporated into the overall Group ORSA process and assessment which considers the risk, capital and solvency position of the Group as a whole.

It is the Group's capital management strategy that economic capital for legal entities is held as close to regulatory capital as possible but at the same time allowing the business to operate effectively. This ensures that adequate levels of capital are held at the Group level for the potential benefit of all legal entities of the Group. As such, given the Company's existing position within the Group we feel that it is appropriate to use the Bermuda Solvency Capital Requirement ("BSCR") methodology as a basis for the measure of our own view of the required capital for the business. This is consistent with prior years and we will continue to assess the appropriateness of this approach to the CISSA as the Company's risk exposures, outstanding liabilities and operating environment change.

### **B.3.3. Relationship between the solvency self- assessment, solvency needs, and capital and risk management**

See section B.3.2.

### **B.3.4. Solvency self-assessment approval process**

An overview of the minimum roles and responsibilities required for the CISSA process and the CISSA Report are set out below.

#### **BOARD**

With respect to the responsibilities relating to ERM, the Board:

- Oversees ERM activities, including the risk management framework employed by management. With respect to the overall risk management framework, the Company's Board (i) reviews the methodology for establishing our overall risk capacity; (ii) reviews the policies for the establishment of risk limit frameworks, and adherence to such limits; and (iii) reviews and approves Company risk limits.
- Oversees our compliance with any significant enterprise risk limits, authorities and policies. The Board evaluates what actions to take with respect to such limits, authorities and policies, and approves any exceptions thereto from time to time as necessary.
- Reviews our overall risk profile and monitors key risks to the Company.
- Monitors our risk management performance and obtains reasonable assurance from management that our risk management policies are effective and are being adhered to.

The review of our overall risk appetites and the evaluation of the risk impact of any material strategic decision being contemplated, including consideration of whether such strategic decision is within the risk profile established by us, is conducted by the Board. "Risk appetites," as referred to above, are broad statements used to guide our risk and reward preferences over time, all consistent with, among other factors, business prudence, market opportunities, the underwriting pricing cycle and investment climate. Risk appetites are regularly monitored and can change over time in light of the above.

The Board shall, as appropriate, be briefed on the outcomes of key elements of the CISSA process and shall:

- Review and challenge outputs of the CISSA process



- Review and challenge the overall annual CISSA report

The Board is made aware of the CISSA outcomes as appropriate.

### **ORSA PROCESS OWNERS**

- The CISSA is made up of a number of different processes and each of these processes has an owner. These process owners are responsible for providing the information to support the undertaking of the CISSA.
- Key CISSA process owners are detailed below:

<b>ORSA Process</b>	<b>Owner</b>
Internal model runs	n/a
Risk Budget (and related stress tests)	Head of Credit Risk Management
Standard Formula Calculations	Chief Financial Officer
Own Funds Calculations	Chief Financial Officer
Technical Provisions Calculations (where appropriate)	Head of Insurance Reserving/Group Financial Reporting
Actuarial Function Report	Head of Insurance Reserving/Group Financial Reporting
Annual Risk Assessment (Risk Register)	ERM function
Business Planning	Chief Financial Officer
Emerging Risks Process	Head of Non Natural Perils Risk Management

It should be noted that the CISSA process owners leverage Group processes and expertise in performance of their duties.

## **B.4. Internal Controls**

### **B.4.1. Internal control system**

Catlin Insurance Company Ltd benefits from the Group's Framework for Internal Controls ('FIC') process. The FIC function is committed to promoting a robust internal financial control framework for the XL Group Ltd Audit Committee, executive management and external stakeholders to rely on for financial and regulatory reporting purposes.

FIC's core strategic objectives include:

- Conducting an effective and efficient assessment of the design and operating effectiveness of internal controls over financial reporting.
- Identifying areas in which the inherent risk of financial misstatement is high so that management can address these risks before they manifest themselves in an actual misstatement.
- Providing the Audit Committee and executive management with the information they need to make the assertions and certifications required.
- Adding value by helping management promote a robust control environment.

The FIC function performs an annual assessment of the control framework which includes: risk identification, risk assessment and planning; documenting business processes; evaluation and validation of key risks and controls; and issue management.

## B.4.2. Compliance function

Catlin Insurance Company Ltd adheres to the XL Group compliance policy. What follows is therefore a description of the XL Group's overall approach to compliance.

The Chief Compliance Officer ("CCO") of XL Group is responsible for the formulation and implementation of an effective compliance program for the XL Group of Companies.

In order to ensure the independence of the CCO, the CCO reports directly to the XL Group Audit Committee on a periodic basis on matters relating to the Company's compliance with applicable law and regulation and the Company's own general standards of legal, ethical and compliant conduct for its employees.

The Company has a designated compliance officer with reporting lines to the CCO.

XL Group Ltd's Enterprise Risk Committee, under delegated authority from the XL Group Ltd's Audit Committee, is responsible for approval of the XL Group's Compliance Policy and Program (the "Compliance Policy") a copy of which is available on the XL Group's public website.

The purpose of the Compliance Policy is to (a) protect XL Group Ltd companies from financial or reputational harm that could arise from noncompliant or unethical conduct; (b) assist to prevent, detect and remediate compliance failures or risks; and (c) seek to ensure that XL Group Ltd companies are in compliance with all applicable laws and regulations.

The CCO is responsible for overall implementation and evaluation of the Compliance Policy and reports, at least annually, on its effectiveness to the XL Group Ltd Audit Committee.

XL Group Ltd maintains a Code of Conduct (the "Code of Conduct ") that explains general standards of legal, ethical and compliant conduct. Material updates to or changes to the Code must be approved by the Board of Directors of XL Group Ltd. The Code of Conduct is available on the Company's public website.

The CCO is responsible for leading an annual Group level assessment of compliance risks presented by the XL Group's business, operations and other activities.

The XL Group Ltd Audit Committee advises the XL Group Ltd Board, at least annually with respect to the Company's policies and procedures regarding compliance with applicable laws and regulations and with the Code of Conduct. The XL Group Ltd Audit Committee also reviews at least annually, with the CCO, compliance with the Code of Conduct, as well as the implementation and effectiveness and the administration, training, monitoring and auditing of the Compliance Policy, and also will discuss with the CCO, the Group General Counsel and the independent auditor, as appropriate, any correspondence with regulators or governmental agencies and any employee complaints or published reports which raise material issues regarding XL Group Ltd's financial statements or accounting policies, or material compliance weaknesses or violations.

Copies of the Compliance Policy and the Code of Conduct are available on XL Group's public website at <http://xlgroup.com/xl-investor-relations/corporate-governance>

The XL Group Ltd Audit Committee to the extent it deems necessary or appropriate, obtains at least annually, or more frequently if appropriate, written reports from the Group General Counsel, Group Compliance Director and CCOs as to whether XL Group Ltd and its subsidiary/ foreign affiliated entities are in material compliance with applicable legal requirements and the Code of Conduct and Compliance Program.

The XL Group Ltd Audit Committee advises the XL Group Ltd Board, at least annually, or more frequently if appropriate, with respect to the XL Group's policies and procedures regarding compliance with applicable laws and regulations and with the Code of Conduct and reviews at least annually or more frequently if appropriate, with the Group General Counsel, the Group Compliance Director, compliance with the Code of Conduct, as well as the implementation and effectiveness and the administration, training, monitoring and auditing of the Compliance Program.

Further information regarding XL Group's approach Compliance Function is publicly available at

## **B.5. Internal audit function**

The objectives of the Internal Audit function are to provide assurance that XL Group's network of risk management, internal control, and governance processes, as designed and represented by management, is adequate and functioning in a manner to ensure:

- Risks are appropriately identified and managed.
- Internal accounting and operating controls are adequate and operating effectively.
- Financial, managerial, operating and technology systems information is appropriate, accurate, reliable, and timely.
- Compliance with policies, standards, procedures, code of conduct and applicable country laws and regulations.
- Resources are acquired economically, used efficiently, and adequately protected.
- Programs, plans, and objectives are achieved.
- Quality and continuous improvement are fostered in the control processes.
- Significant legislative or regulatory issues are recognized and addressed properly.
- Achievement of the Company's strategic objectives.

### **B.5.1 Internal audit process**

Catlin Insurance Company Ltd follows the XL Group internal audit process.

The internal audit process is set out below:

1. Engagement Planning: The objectives of this phase are to refine the scope; identify which business processes, systems and controls will be evaluated; determine which techniques will be used; manage expectations; and coordinate with FIC, external auditors, and IT Audit.
2. Risk and Control Evaluation: The objective of this phase to understand the business process, the key controls and the primary risks associated with the business process.
3. Fieldwork and Testing: The auditor will determine whether the controls supporting the audit objectives are adequately designed and effective through the gathering of audit evidence.
4. Reporting: This phase provides a well-supported opinion on the controls in place, provide value added recommendations and identify opportunities to improve the internal control environment.
5. Follow-up and Closure: The objective of this phase is to monitor the outstanding audit recommendations and agreed-upon audit issue resolutions to ensure their timely implementation.

### **B.5.2 Internal audit independence**

The Internal Audit Department complies with the International Standards for the Professional Practice of Internal Auditing of The Institute of Internal Auditors (IIA). The Standards apply to individual internal auditors and internal audit activities. All internal auditors are accountable for conforming to the Standards related to individual objectivity, proficiency and due professional care.

The IIA has also established a Code of Ethics which covers basic principles of the internal auditing practice. Internal Audit has a responsibility to conduct itself so that its good faith and integrity are not open to question.

Internal Audit activity is mandated through a written internal audit charter that establishes Internal Audit's purpose, authority, and responsibility to support its independence and objectivity within XL. The XL Group Audit Committee safeguards the independence by approving the internal audit charter at least annually.

To ensure independence, the Chief Audit Executive (CAE) reports directly to the XL Group Audit Committee and has direct communication with the XL Group Audit Committee. (For day to day administrative purposes, the CAE reports to the Chief Executive Officer of XLG.) The XL Group Audit Committee is also responsible for the appointment, removal, and determination of the compensation of the CAE.

To ensure objectivity, Internal Audit does not assume any operational responsibility for any activity for which they had any authority or responsibility within the past year or a period significant enough to influence their judgment or opinion.

At least annually, each member of the Internal Audit team confirms that they abide by the policy and procedures of the department as well as the XLG Code of Ethics, avoiding conflicts of interest or disclosing any activity that could result in a possible conflict of interest.

## **B.6. Actuarial function**

The Actuarial Function (the "Actuarial Function") assists the Board with its oversight responsibilities.

### **Regulatory Compliance**

The Actuarial Function operates in accordance with applicable Bermuda regulation.

### **Roles and Structure**

The Actuarial Function is provided at the Group level from the Group Actuarial Department that is headed by the Global Chief Actuary.

The Group's Approved Actuary and the Actuarial Function which advises the Board is established internally, as opposed to being outsourced to third-party service providers, and is embedded in the Group's corporate governance framework. The Group is committed to maintaining an effective Actuarial Function to ensure that the business is conducted in an appropriate and reasonable manner within the Group.

The Actuarial Function is split into two core functions: Actuarial Reserving / Financial Reporting which is responsible for loss reserving and reporting and Pricing and Analytics which is responsible for pricing and underwriting.

The responsibilities of the Actuarial Function are shared by a number of key individuals who are supported by their respective teams. These teams are of sufficient size, and consist of suitably qualified and experienced people that meet the Group's minimum fitness and proper employment criteria. The teams are structured with varying lines of defence to facilitate effective peer review and independent challenge.

### **Reports of the Actuarial Function to the Board and Regulators**

The Actuarial Function provides expert actuarial advice to the Board through formal reports and presentations.

### **Actuarial Function Responsibilities**

The Actuarial Function is involved in many of the key processes across the business and provides technical expertise and assurance over the methods used. The key processes are:

- Estimating the gross and net technical provisions;

- Ensuring the appropriateness of the methodologies and underlying models used as well as the assumptions made in the calculation of technical provisions and explaining any material effect of change of data, methodologies or assumptions between valuation dates on the amount of technical provisions;
- Assessing the sufficiency and quality of the data used in the calculation of technical provisions and where relevant providing recommendations on internal procedures to improve data quality;
- Informing the Board on the reliability and adequacy of the calculation of technical provisions; overseeing the calculation of technical provisions;
- Assisting in the execution of the risk management framework and ensuring an effective governance framework around the review and validation of loss reserves (including technical provisions), policyholder obligations and potential exposures, which includes:
  - i. Regular contact by reserving actuaries with underwriting and claims teams;
  - ii. Review of technical provision results by an escalating series of reviews from reserving actuaries to the global chief actuary;
  - iii. Review of technical provisions to provide sufficient independence from management;
  - iv. Independent external analysis of the reserving requirements; and
- Ensuring that the actuarial methods and techniques are compliant with all the appropriate regulatory requirements;
- Assisting with the underwriting process, including those surrounding pricing and design of underwriting contracts and risk transfer mechanisms;
- Helping to maintain a competent, effective and efficient approach to pricing;
- Comparing best estimates against experience, i.e. performing analysis comparing the estimated policyholder obligations against actual policyholder obligations paid;

Additional responsibilities relating to capital modelling:

- The Actuarial Function has an additional responsibility in contributing to the effective implementation of the risk management system, in particular with respect to providing inputs and offering insights related to the risk modelling underlying the calculation of the capital requirements within the internal model;

The Actuarial Function is responsible for specifying which risks within their domain of expertise are covered by the internal model. The Actuarial Function also offers insights into the nature of dependencies between these risks.

## **B.7. Outsourcing**

### **B.7.1. Outsourcing policy and key functions that have been outsourced**

The Company follows the XL Group Ltd Outsourcing policy which will apply to all XL Group Material Outsourcing Arrangements. There are specific materiality thresholds for critical or important activities such as the following:

- Arrangements with an individual vendor covering business services to a certain annual value;
- Specific delegated underwriting arrangements based upon agreed criteria and the Risk Based Approach (RBA) Guidelines

- Specific delegated claims handling arrangements identified by the Claims Delegated Arrangement team based upon certain outstanding claims reserves or the Group's Outsourcing Sub Committee ("GOSC");
- Specific Investment Management arrangements as identified by XL Investments Ltd; and
- Other ad hoc outsourcing arrangements that GOSC may consider as being material to XL Group for financial, operational or reputational reasons

This applies to all material outsourcing to third parties carried out by XL Group and its subsidiaries and is designed to establish a framework for the oversight and management of outsourcing risk at Group level, as well as the oversight of specific outsourcing arrangements. The Outsourcing Process for all Material Outsourcing Arrangements consists of the steps below:

**Due Diligence** - A thorough review of the service provider is to be performed using the services of IT, Legal and Compliance, Finance, Business Continuity Management, Risk Management and external experts when appropriate;

**Contracting and Negotiations** - All material outsourcing agreements must be undertaken using a written, legally binding agreement approved by Legal and Compliance in accordance with agreed minimum standards;

**Regulatory Notification** - Ensure any prior notification required to relevant regulatory supervisory body is made;

**Performance Monitoring** - Ensure procedures to monitor the service provider's performance and risk are put in place; and

**Exit Phase** - Ensure all necessary exit strategies and business continuity plans are in place, relevant information exchanges is returned or destroyed, service provider access is ceased; and in the case of early termination, if any claims or penalties against the service provider arise.

### **B.7.2. Material intra-group outsourcing**

Services and resources are provided to entities within the Group by other Group companies, primarily through service companies. Formal service level authority agreements exist for services provided by these companies to other entities within the Group.

Outside of the intra-group service provision framework outlined above, additional agreements may be in place for further specific functions provided by an XL Group company and another entity within the Group. For example, XL Group Investments Ltd ("XLGIL") provides investment management services to other entities within the XL Group. These can be summarised as follows:

- Advising on investment strategy;
- Appointing investment managers;
- Providing investment reporting;
- Setting benchmarks

### **B.8. Other material information**

For the year ended December 31, 2106, there is no other information relating to business and performance required to be disclosed for purposes of this Financial Condition Report.

## **C. Risk Profile**

The Company has an agreed approach to the definition and categorisation of risks. Risk exposures are either directly assumed by the Company (including inter company cessions) and also through ownership interests in other XL Group subsidiaries:



## C.1. Material risks the insurer is exposed to during the period

See below as pertains to the Company and its subsidiaries.

### C.1.1. Underwriting risk

Underwriting risk (Insurance risk) is defined using the following categories:

Component	Definition
<b>Underwriting risk</b>	Underwriting risk derives from insurance and reinsurance policies written for the current period and also from unearned exposure from prior periods. The risk is that the corresponding premium will be insufficient to cover future claims and other costs or more generally that the underwriting profitability from this tranche of business will be less than expected. Underwriting risk includes man-made catastrophe events and natural catastrophe events.
<b>Reserve risk</b>	Reserve risk relates to policy liabilities (corresponding to business written in prior periods where the exposure has already been earned at the opening balance sheet date) being insufficient to cover the cost of claims and associated expenses until the time horizon for the solvency assessment. Additional risks are that the timing or amount of actual claims pay outs do not align with the timing or amounts of the estimated claims pay outs and that there are changes in the valuation of the market value margin (risk margin) during the time horizon for solvency assessment.
<b>Lapse risk</b>	Lapse risk is the risk of loss, or of adverse change in the value of insurance future profits, resulting from changes in the level or volatility of the rates of policy lapses, terminations, renewals and surrenders. This includes policies where an assumption has been made about renewal that may not be warranted based on past experience either in terms of actual treaties or underlying policies issued and renewable.

Underwriting and loss experience is reviewed regularly for, among other things, loss trends, emerging exposures, changes in the regulatory or legal environment as well as the efficacy of policy terms and conditions. Underwriting risk is also identified through:

- **Business planning** - Analysis is undertaken of the underwriting portfolio, exposures, loss experience and changes to the external environment (including market cycle, economic environment) to identify any changes to the insurance risk profile for the forthcoming period of the budget / business plan;
- **Underwriting processes (including guidelines and escalation authorities)** - Each individual contract written is assessed, by the underwriting process (which is subject to granular underwriting guidelines and escalation authorities) for the nature and level of insurance risk that it brings to the business including consideration of the exposure by nature of the limit, the risks insured, the location of the risks and other underwriting criteria.;
- **Reserving and claims process** - On an ongoing basis, claims trends are monitored and analysed for any indications of change in the nature of the underlying insurance risk;
- **ERM risk assessment process** - Through the risk assessment processes, the Company quantifies existing risks and also identifies new risks; and

- **Realistic Disaster Scenarios ("RDS") and other scenarios.**

### C.1.2. Market risk

Market risk represents the potential for loss due to adverse changes in the fair value of financial and other instruments. The Company is principally exposed to the following market risks:

Component	Definition
<b>Interest Rate</b>	Financial loss or volatility of profits due to the combined sensitivity of the economic value of the investment portfolio to changes in the level or volatility of risk-free (or other benchmark) interest rates.
<b>Equity - Investment Portfolio</b>	Financial loss or volatility of profits due to the sensitivity of the value of the investment portfolio to changes in the level or in the volatility of market prices of equities.
<b>Real Estate - Investment Portfolio</b>	Financial loss or volatility of profits due to the sensitivity of the investment portfolio to change in the level or in the volatility of market prices of real estate.
<b>Spread - Investment Portfolio</b>	Financial loss or volatility of profits due to the sensitivity of the market values of the investment portfolio to changes in the level or in the volatility of credit spreads.
<b>Exchange rate risk</b>	Volatility in the Company's shareholder's equity due to changes the value of the Company's non-USD net assets when translated back to the Company's USD reporting currency.
<b>Concentration</b>	Financial loss or volatility of profits due to the increased sensitivity of the market value of the investment portfolio to other risks specifically due to concentrations of investments such as in specific geographical region, industry or company.
<b>Commodity Impact on Investment Portfolio</b>	Financial loss or volatility of profits due to the sensitivity of the market value of the investment portfolio to changes in the level or in the volatility of market prices to commodities.
<b>Inflation impact on investment portfolio</b>	Financial loss or volatility of profits due to the sensitivity of the market values of the investment portfolio to changes in the level or in the volatility of inflation rates.

The Company identifies market risk through the following processes:

Process	Description
<b>Business planning</b>	As part of the annual planning process, a review is undertaken of the nature of assets required to support the business plan and the expected liabilities.
<b>Investment decisions and asset allocations</b>	The XL Group Investment Portfolio Guidelines, Authorities and Monitoring Framework, which applies to the Company, sets ranges for tactical deviation from the benchmark and is reviewed annually.
<b>ERM Risk assessment and processes</b>	The risk assessment process assists in identifying if there are any changes to market risks already identified in the previous assessment.

Market risk is also identified through the Group's Emerging Risk Taskforce which has Company representation .

### C.1.3. Credit risk

Credit risk is defined as the risk of loss due to an unexpected default, or deterioration in the credit standing of the counterparties and debtors or uncertainty of an obligator's continued ability to make timely payments in accordance with the contractual terms of the instrument.



Credit risk through the risk framework is categorised by the following:

Component	Description
<b>Reinsurance counterparty Risk</b>	Risk of losses due to the default of a reinsurer or a deterioration of its credit worthiness
<b>Investment counterparty Risk</b>	Counterparty default risk is the risk of possible losses due to the unexpected default, or deterioration in the credit standing of investment counterparties
<b>Premium counterparty Risk</b>	Premium counterparty default risk is the risk of possible losses due to unexpected default, or deterioration in the credit standing of the premium debtors in relation to insurance contracts written
<b>Underwriting counterparty Risk</b>	Exposure to credit risk through certain credit sensitive underwriting activities which include, but are not limited to, Surety, Worker's Compensation, Environmental and Political Risk and Trade Credit

The Company identifies credit risk through the following processes:

Process	Description
<b>Business planning</b>	Analysis is undertaken of the credit risk exposures, loss experience and changes to the external environment (including market cycle and economic environment) to identify any changes to the credit risk profile for the forthcoming period of the business plan.
<b>Underwriting</b>	Each individual contract written is assessed, by underwriting process (which is subject to granular underwriting guidelines and escalation authorities) for the nature and level of credit risk that it brings to the business including consideration of the exposure by nature of the limit, the risks insured, the location of the risks and other underwriting criteria.
<b>ERM Risk assessment and processes</b>	Through the risk assessment processes, the Company quantifies existing risks and also identifies new risks.
<b>Emerging risks</b>	The Group operates an emerging risks identification process. This assessment identifies key external factor changes that may give rise to credit risk issues. The process also evaluates potential opportunities that might arise from these emerging risks.

#### **C.1.4. Liquidity risk**

Liquidity risk is defined as the inability to meet cash and collateral posting obligations when they come due. Liquidity risk arises from three principal areas: operating, financing and investing cash flows. The RMF addresses how the Company manages liquidity both under a normal and a stressed environment.

The Company identifies liquidity risk through the following processes:

Process	Description
<b>Stress testing</b>	Stressing known and forecasted liquidity positions, downgrade triggers, collateral demands and cash flows by legal entity.
<b>Treasury</b>	Treasury has responsibility to identify and monitor concentration risk of cash at banks, along with funding requirements.
<b>ERM Risk assessment and processes</b>	Through the risk assessment processes, the Company quantifies existing risks and also identifies new risks.

### C.1.5. Operational risk

The Company defines operational risk as the risk of loss, resulting from inadequate or failed internal controls and / or processes, or from people and systems, or from external events. In line with business objectives, the Company does not take on operational risk with a view to achieving enhanced return. Rather, it accepts operational risk as a consequence of writing (re)insurance business and having operations to support the writing of that business.

Operational risk is identified through the following processes:

Process	Description
<b>Annual risk assessment</b>	A risk register is maintained of the material risks faced by the Company. On an annual basis an assessment is performed on the risks on the risk register.
<b>Consultation regarding new regulations</b>	When the regulatory authorities announce potential changes to the regulatory environment (such as new rules and regulations) the Legal and Compliance team is responsible for reviewing the proposed changes and for highlighting any increase in regulatory risk that might arise. When new financial reporting regulations are announced, the CFO is responsible for reviewing the proposed changes and for highlighting any increase in regulatory risk that might arise.
<b>Business planning</b>	Any changes to the operational risk environment that arise as a result of the business planning (such as entry into new territories) must be identified and accounted for during the planning process.
<b>Ongoing operations</b>	Function heads and Risk Owners are responsible for identifying any new (or changed) risks during the normal course of business, and notifying the Policy Owners so any required changes to the risk register can be implemented.
<b>Emerging risks</b>	The Company benefits from a Group wide emerging risks identification process which captures emerging risks. This assessment identifies key external factor changes that may give rise to operational risk issues.
<b>Internal loss data</b>	The Company benefits from a Group process which collects data relating to operational risk losses and near misses on a quarterly basis. The data collected is used, among other things, to track incidents, identify key risk indicators and to validate and challenge operational risk quantification.
<b>External loss data</b>	The Company benefits from a Group process which purchases historical loss data from an external provider. Large events from this database are used to identify new emerging risks.

### C.1.6. Other material risks

Asset liability mismatch risk arises directly from a mismatch between assets and liabilities due to changes in market and credit risks, liquidity and foreign exchange and also arises from events affecting both asset and liability values.

In particular, two market risks influence both assets and liabilities and are hence key drivers of risk:

Component	Definition
<b>Interest rate and spread risk and asset composition risk</b>	Mismatches between asset composition and maturities and the profile of liability cash flows creates economic risks from changes in benchmark interest rates, spreads and asset values. This is due to changes in the nominal mark-to-market (MTM) value of assets not exactly offsetting changes in the nominal economic value (net-present value) of liability cash flows.
<b>Inflation risk</b>	Differences in the inflation sensitivity of investments, liability and debt cash flows creates a risk to unexpected changes in different types of inflation (Consumer Price Index, wage, etc.). This is due to changes in the real Mark-to-Market value of assets not offsetting changes in the real economic value (net-present value) of liability cash flows.

#### Risk identification

The following outlines the processes used to identify asset liability mismatch risk:

Process	Description
<b>Business planning</b>	As part of the annual strategic planning process, a review is undertaken of the nature (quality, duration, currency and liquidity) of assets required to support the business plan and the expected liabilities.
<b>Investment decisions and asset allocation</b>	The Investment Portfolio Guidelines, Authorities and Monitoring Framework sets ranges for tactical deviation from the benchmark and is reviewed annually in conjunction with the SAA process as outlined in C2 Market Risk.
<b>ERM risk assessment and processes</b>	The risk assessment processes assists in identifying if there are any changes to ALM risks from those that had been identified in the previous risk assessment.

#### Risk mitigation

The Company controls asset liability mismatch risk through:

- **Asset Liability Management (ALM) analysis**

The Company will conduct detailed ALM analyses to match the average duration of its liabilities with appropriate assets.

- **Investment authorities and guidelines**

Board approved market risk authority and guidelines are in place that addresses all the key market risk factors and is commensurate with the volume and complexity of activity undertaken by the Company.

- **Reserving process controls**

Among the key drivers of the Company's reserve risks are inflation, correlation across lines of business, legislative and regulatory changes, loss trend movements, timing and reporting changes at underlying ceding companies, and the excess nature of exposures in certain lines including non-proportional reinsurance

#### Stress testing framework

The Company uses scenario testing as one method to assess asset liability mismatch risk exposures. The Group undertakes a number of stress tests covering historical events and hypothetical scenarios to understand the impact of such scenarios to the investment portfolio. The results of these are allocated to all legal entities within the Group.

## C.2. Risk mitigation in the organisation

This section pertains to the Company and its subsidiaries

#### Underwriting risk

##### Reinsurance purchase

The Company participates in an XL Group managed outwards third party reinsurance risk transfer programme to support the Company's underwriting strategy within risk appetite and to ensure efficient use of capital. Business ceded varies by location and line of business based on a number of factors, including market conditions. The goals of the outwards reinsurance risk transfer program include reducing exposure on individual risks, protecting against catastrophic risks, maintaining acceptable capital ratios and enabling the writing of additional business. The overall goal of the program is to reduce volatility and enhance overall capital efficiency.

The adequacy of the Group reinsurance strategy as a protection mechanism for the Company is considered and is approved by the Company Board as part of the annual business planning process, and the impact of that strategy is monitored quarterly by the Board.

##### Actuarial Function

To mitigate the risk of large changes of reserves from one period to the next which are not due to external but to internal factors such as human errors, the reserving process performed by the Actuarial Function is highly structured and strictly defined and controlled and includes several layers of oversight.

##### Rating adequacy

Underwriters are supported by dedicated teams of claims personnel and pricing actuaries. Premiums are set and adjusted based, in large part, on the industry group in which the insured is placed and the perceived risk of the insured relative to the other risks in that group. The rating methodology used for individual insureds seeks to set premiums in accordance with claims potential. Underwriting guidelines and policy forms differ by product offering as well as by legal jurisdiction.

##### Underwriting authorities and guidelines

All underwriters are assigned individual underwriting authorities with the objective of preserving the capital base and controlling earnings volatility. Authorities within the business units are delegated through the underwriting management structure and the annual review of underwriting limits is part of the business planning process. Authorities are also set in line with agreed risk appetites and risk tolerances for material individual events, the investment portfolio, Realistic Disaster Scenarios ("RDS") that cross multiple lines of business and from risks related to some or all of the above that may occur concurrently.

The Company underwrites and prices most risks individually following a review of the exposure and in accordance with its underwriting guidelines. The Company seeks to meet our clients' needs while controlling our exposure both on a portfolio basis and on individual insurance contracts through terms and conditions, policy limits and sub-limits, attachment points and reinsurance arrangements on certain types of risks.

#### Market risk

##### Strategic Asset Allocation

The Strategic Asset Allocation (SAA) process establishes a benchmark that is constructed to maximise enterprise value, subject to various considerations and constraints.

- Authorities Framework

As part of the implementation of the Company's SAA Benchmark, a comprehensive framework of investment decision authorities is employed. The objective of the Authorities Framework is to ensure that the risk profile of the investment portfolio is consistent with the Company's risk tolerance as reflected in the SAA Benchmark. The Authorities Framework controls active or tactical deviations from the SAA Benchmark. As the magnitude of these deviations increases or the resulting impact on the risk profile of the investment portfolio reaches certain predetermined thresholds, additional levels of authority and approval are required.

The Statement of Investment Policy, Authorities and Guidelines and XL Group Investment Portfolio Guidelines, Authorities and Monitoring Framework comprise a market risk authority and guidelines structure that addresses all the key market risk factors and is commensurate with the volume and complexity of activity undertaken by XL Group.

- Service level agreements

Service level agreements are in place between XL Group Investments Ltd (“XLGIL”) and the Company. These include guidance on type of investments and the average weighted credit ratings of the portfolio that can be made on behalf of the Company. Adherence to policies and guidelines is monitored and signed off by XLGIL on a regular basis and subject to monitoring and reporting to the Company’s Board as described below.

#### Currency risk mitigation

The Company is primarily exposed to currency risk in respect of liabilities under policies of insurance denominated in currencies other than US Dollars. The Company seeks to mitigate the risk by matching the estimated foreign currency denominated liabilities with assets denominated in the same currency.

#### Credit risk

Credit risk is managed through:

- **Credit risk framework:** Credit risk arising from credit sensitive underwriting activities is managed via the underwriting limit framework. Credit risk is managed within the investment portfolio through the Authorities Framework and established investment credit policies, which address the quality of obligors and counterparties, industry limits, and diversification requirements. Exposure to market credit spreads primarily relates to market price and cash flow variability associated with changes in credit spreads.
- **Underwriting authorities and limits:** See C.1.1 Underwriting Risk.
- **Investment portfolio:** Credit risk is managed in the investment portfolio, including fixed income, alternative and short-term investments, through the credit research performed by both investment management service providers and the Group’s in house portfolio management team.

**Reinsurance Security Department:** The Company manages its credit risk in its external reinsurance relationships by transacting with reinsurers that it considers financially sound, and if necessary, collateral in the form of funds, trust accounts and/or irrevocable letters of credit may be held.

#### Liquidity risk

One of the principal objectives of liquidity risk management is to ensure that there is readily available access to funds with which to settle large or multiple unforeseen claims.

Cash needs include all possible claims on cash from policyholders, shareholders and operations. Some of these cash outflows are scheduled while others are known with much less certainty. The goal is to ensure sufficient liquidity in the asset portfolio, together with secured external cash sources, to provide for timely payment of potential cash demands under both normal business conditions and under extreme conditions resulting from unforeseen events over a 12 month horizon.

Liquidity risk is managed through:

- **Investment portfolio liquidity** - The annual SAA process determines the structure of the benchmark that maximises the value of the Company subject to risk tolerance and other constraints. The key output of the SAA process is an investment portfolio benchmark, which takes into account management’s risk tolerance, liability cash flows, business plan and regulatory considerations.
- **Asset-Liability Management (ALM)** - The Company benefits from detail Group analyses which match the average duration of its liabilities with appropriate assets.

### Operational risk

The Company's risk register details the controls in place that mitigate specific risks. The nature of the controls (e.g. preventative or detective; manually operated or automatic) and the strength of control exercised are based upon the:

- Potential severity of the risk;
- Frequency of the risk occurring;
- Cost of implementing controls relative to the significance of the risk; and
- Appetite and tolerance for the risk.

### ***Purchase of insurance***

It is recognised that while the Company may buy insurance with the aim of reducing the monetary impact of certain operational risk events (e.g. physical damage), non-monetary impacts may remain (including impact on the Company's reputation). This is considered in the risk assessment process and risk register.

The risks are monitored and managed through the risk framework and the operational loss event reporting process.

Based on the above factors considered in scenario and stress testing, all operational risks are deemed to be well managed and within risk appetite, as reported via the Risk Dashboard and CISSA report to the Board.

The Company's employees are expected to conduct themselves in accordance with XL Catlin's Code of Conduct. Further, the Company conducts its business in such a way as to comply with laws and regulations, and in compliance with the RMF.

## **C.3. Material risk concentrations**

This section pertains to the Company and its subsidiaries.

Material concentrations can occur within risk categories and across risk categories. The limit framework and expected exposures are reviewed during the annual risk budgeting process and tested through our stress testing framework.

### **Underwriting Risk:**

We impose limits certain for key risks at a 1% and a 0.4% exceedance probability. If we were to deploy the full limit, for any given event type, there would be a 1% and a 0.4% probability, respectively that an event would occur during the next year that would result in a net underwriting loss in excess of the limit. We also impose limits for certain exposures at a 1% tail value at risk ("TVaR") probability. This statistic indicates the average amount of net loss expected to be incurred if a loss above the 1% exceedance probability level has occurred.

### **Market and Credit Risk**

An embedded stress testing framework is used to understand possible impacts of major risks, including market risks. The following stress and scenario tests are used to identify risk exposures:

- Interest rate and spread sensitivities: by re-valuing current portfolio holdings assuming various changes in the level and term structure of interest rates and the level of credit spreads;
- Historical stress tests and Black Swan scenarios identified by ERM and the XL Group Investments Ltd covering economic, financial and political events and the potential impact to the investment portfolio.

## C.4. Investment in assets in accordance with the prudent person principles of the Code of Conduct

In line with business objectives, market risk is accepted by the Company and managed with the objective of optimising total return on investments subject to agreed risk constraints and other considerations. Our investments are managed and monitored by XL Group Investments Ltd and governed through an investment agreement and guidelines. The ERM department oversee adherence to these guidelines.

XLGIL is guided by the “prudent person” principle as specified in paragraph 5.1.2 of the BMA Insurance Code of Conduct, in that the Company only invests in assets and instruments where the risks of which can properly be identified, measured, monitored, managed and controlled. Exposures to counterparty concentrations are managed through defined limits and ratings.

## C.5. Stress testing and sensitivity analysis to assess material risks

This section pertains to the Company and its subsidiaries.

### Underwriting risk

There is an embedded stress testing framework that is used to understand possible impacts of major risks, including underwriting risks (natural catastrophe, terrorism and Realistic Disaster Scenarios). These impacts include the earnings, underwriting, investments, liquidity and capital implications of low frequency, high severity events.

### Market risk

The Company’s investment portfolio is invested in accordance with the approved investment guidelines.

Day-to-day management of the investment portfolio is conducted through a combination of in-house portfolio management teams and external asset managers in accordance with detailed investment guidelines and risk tolerances, that are closely monitored by XLGIL. This hybrid implementation approach provides access to external asset managers with specialised skills across a broad range of investment products, as well as the flexibility to actively manage the overall structure of the portfolio in line with the Company’s specific business needs. Interaction between the internal and external managers provides additional insight to take advantage of opportunities as they present themselves.

The delegation of investment authority to XLGIL is supplemented by robust compliance monitoring with defined escalation and notification procedures. This framework is designed to identify investment risks in absolute and relative terms, and to consistently and objectively measure, assess, manage and report such risks on an ongoing basis. The framework is cascaded down to the Company, and approved by the Board.

### Credit risk

ERM consolidates credit exposure reports from corporate functions and underwriting businesses on a regular basis for aggregating, monitoring and reporting to the Group Credit Risk Committee and Company Board.

On a regular basis a review is undertaken of the investment portfolio to enrich our understanding of asset concentrations as well as credit quality and adherence to our credit limit guidelines. Any issuer over its credit limits or experiencing financial difficulties, material credit quality deterioration or potentially subject to forthcoming credit quality deterioration is placed on a watch list for closer monitoring. Where appropriate, exposures are reduced or prevented from increasing.

### Liquidity risk

The investment portfolio is structured with the aim to ensure that adequate income is generated to meet ongoing liquidity needs. Also the Company would generally expect that positive cash flow from operations (underwriting activities and investment income) will be sufficient to cover cash outflows under most future loss scenarios. However, there is a possibility that unforeseen demands could be placed on us due to extraordinary events and, as such, our liquidity needs may change.

Therefore, maintaining sufficient liquidity to ensure payment of claims, operating expenses and other obligations, even during stressed scenarios, is one of the input factors when defining our investment portfolio. In addition, we maintain credit facilities that provide liquidity.

Quarterly liquidity stress test analysis is conducted by the Group Treasury team.

#### Operational risk

Operational risk is assessed and monitored through the risk assessment process.

### **C.6. Other material information**

For the year ended December 31, 2106, there is no other information relating to business and performance required to be disclosed for purposes of this Financial Condition Report.

## **D. Solvency Valuation**

This section provides particulars of the valuation bases, methods and assumptions on the inputs used to determine solvency.

### **D.1. Valuation bases, assumptions and methods used to derive the value of each asset class**

**Cash and cash equivalents** include money-market funds and fixed interest deposits placed with a maturity of under 90 days when purchased. This also includes restricted cash. Cash and cash equivalents are included in the Economic Balance Sheet ("EBS") at fair value in line with US GAAP with both changes in fair value and realized gains/losses netted off Statutory Economic Capital and Surplus.

**Quoted Investments** are recorded at fair value in line with US GAAP with both changes in fair value and realized gains/losses are recorded on the Statutory Statement of Income.

**Unquoted investments** are recorded at fair value in line with US GAAP with both changes in fair value and realized gains/losses are recorded on the Statutory Statement of Income. In cases where the GAAP principles do not require fair value, the Company values the unquoted investment using the EBS valuation hierarchy.

The key reason for the difference between EBS and US GAAP for investments is due to certain investments in the US GAAP balance sheet are held at amortized cost. Under EBS all of these investments are required to be held at fair value.

The majority of our investments are bonds, the valuation of which is classified as Level 2 (quoted prices for similar assets) as they are not considered to be traded in an active market. With an active market financial instruments should be traded multiple times per day. This cannot be asserted for our bonds as they do not necessarily trade every day. A small amount of investments are measured at Level 3 (mark to model).

The fair values for investments are generally sourced from third parties. The fair values of fixed income securities are based upon quoted market values where available, "evaluated bid" prices provided by third party pricing services ("pricing services") where quoted market values are not available, or by reference to broker or underwriter bid indications where pricing services do not provide coverage for a particular security.

To the extent the Company believes current trading conditions represent distressed transactions, the Company may elect to utilize internally generated models. The pricing services use market approaches to valuations using primarily Level 2 inputs in the vast majority of valuations, or some form of discounted cash flow analysis, to obtain investment values for a small percentage of fixed income securities for which they provide a price. Pricing services indicate that they will only produce an estimate of fair value if there is objectively verifiable information available to produce a valuation.

Standard inputs to the valuations provided by the pricing services listed in approximate order of priority for use when available include: reported trades, benchmark yields, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers, and reference data. The pricing services may prioritize inputs differently on any given day for any security, and not all inputs listed are available for use in the evaluation process on any given day



for each security evaluation; however, the pricing services also monitor market indicators, customer feedback through a price challenge process and industry and economic events. Information of this nature is a trigger to acquire further corroborating market data. When these inputs are not available, they identify "buckets" of similar securities (allocated by asset class types, sectors, sub-sectors, contractual cash flows/structure, and credit rating characteristics) and apply some form of matrix or other modelled pricing to determine an appropriate security value which represents their best estimate as to what a buyer in the marketplace would pay for a security in a current sale.

While the Company receives values for the majority of the investment securities it holds from pricing services, it is ultimately management's responsibility to determine whether the values received and recorded in the financial statements are representative of appropriate fair value measurements. It is common industry practice to utilize pricing services as a source for determining the fair values of investments where the pricing services are able to obtain sufficient market corroborating information to allow them to produce a valuation at a reporting date. In addition, in the majority of cases, although a value may be obtained from a particular pricing service for a security or class of similar securities, these values are corroborated against values provided by other pricing services.

Broker/dealer quotations are used to value fixed maturities where prices are unavailable from pricing services due to factors specific to the security such as limited liquidity, lack of current transactions, or trades only taking place in privately negotiated transactions. These are considered Level 3 valuations, as significant inputs utilized by brokers may be difficult to corroborate with observable market data, or sufficient information regarding the specific inputs utilized by the broker was not available to support a Level 2 classification. See below for further discussions on Level 3 valuations.

Short-term investments include investments due to mature within one year from the date of purchase and are valued using the same external factors and in the same manner as fixed income securities. Equity securities include investments in open end mutual funds and shares of publicly traded alternative funds. The fair value of equity securities is based upon quoted market values (Level 1), or monthly net asset value statements provided by the investment managers upon which subscriptions and redemptions can be executed (Level 2).

**Investments in and Advances to Affiliates.** The Company consolidates holdings in affiliates where it is deemed to have control under its US GAAP accounting principles..

Investments in related affiliates where the Company does not hold a majority equity interest but has the ability to exercise significant influence over operating and financial matters are valued with the equity method and to arrive at an EBS valuation, deductions including goodwill and other intangible assets are made. Holdings where the Company has neither control nor significant influence are treated as quoted / unquoted investments as described above.

Advances to affiliates are recorded at fair value in line with US GAAP. Amounts receivable or payable on account of policies of insurance or reinsurance with affiliates are not included in this line. Such amounts are included in accounts and premiums receivables line and reinsurance payable respectively. Funds held by ceding reinsurers which are affiliates and funds held under reinsurance contracts with affiliates are also not included.

When financial statements of the affiliate are not available on a timely basis to record the Company's share of income or loss for the same reporting periods as the Company, the most recently available financial statements are used. This lag in reporting is applied consistently. The Company generally records its alternative and private investment fund affiliates on a one-month and three-month lag, respectively, and its operating affiliates on a three-month lag. Significant influence is generally deemed to exist where the Company has an investment of 20% or more in the common stock of a corporation or an investment of 3% or more in closed end funds, limited partnerships, LLCs or similar investment vehicles. Significant influence is considered for other strategic investments on a case-by-case basis. Investments in participations are not subject to fair value measurement guidance as they are not considered to be fair value measured investments under GAAP or EBS. However, impairments associated with investments in affiliates that are deemed to be other-than-temporary are calculated in accordance with fair value measurement guidance and appropriate disclosures included within the financial statements during the period the losses are recorded.

**Real Estate** includes land and properties owned, and occupied by the Company and is recorded at cost less any accumulated depreciation and impairment loss under US GAAP. This is deemed to be materially equivalent to fair value and is used as a proxy for fair value under EBS.

**Investment Income Due and Accrued** is recorded at fair value in line with US GAAP. Balances due in more than one year have not been discounted as this is not considered to be material.

**Accounts and premium receivable** are recorded at fair value in line with US GAAP. Premiums due but not yet received are included on this line while premiums not yet due are included as part of premium provisions. Balances due in more than one year have not been discounted as this is not considered to be material.

**Reinsurance balances receivable** are recorded at fair value in line with US GAAP. Losses and loss expenses recoverable are included on line 17 of the Company's EBS. Balances due in more than one year have not been discounted as this is not considered to be material.

**Funds held by ceding reinsurers** (whether affiliate or not) are recorded at fair value in line with US GAAP.

**Deferred acquisition costs ("DAC")** are costs relating to the acquisition of new business for insurance contracts. Under US GAAP these costs are deferred to the extent that they are expected to be recovered out of future margins in revenues on these contracts. DAC are implicitly included in the premium provisions valuation and not reflected as an asset in the EBS.

**Sundry Assets** Any asset not accounted for in lines 1 to 12 and 14 of the Company's EBS is included here if it has a readily realizable value. Any other assets, prepaid and deferred expenses, goodwill and similar intangible assets shall be non-admitted assets.

Derivative instruments are recorded at fair value in line with US GAAP with both changes in fair value and realized gains/losses netted off Statutory Economic Capital and Surplus.

Derivative contracts can be exchange-traded or over-the-counter ("OTC"). Exchange-traded derivatives (futures and options) typically fall within Level 1 of the fair value hierarchy depending on whether they are deemed to be actively traded or not. OTC derivatives are valued using market transactions and other market evidence whenever possible, including market-based inputs to models, model calibration to market clearing transactions, broker or dealer quotations or alternative pricing sources where an understanding of the inputs utilized in arriving at the valuations is obtained. Where models are used, the selection of a particular model to value an OTC derivative depends upon the contractual terms and specific risks inherent in the instrument as well as the availability of pricing information in the market. The Group generally uses similar models to value similar instruments. Valuation models require a variety of inputs, including contractual terms, market prices, yield curves, credit curves, measures of volatility, prepayment rates and correlations of such inputs. For OTC derivatives that trade in liquid markets, such as generic forwards, interest rate swaps and options, model inputs can generally be verified and model selection does not involve significant management judgment. Such instruments comprise the majority of derivatives held by the Group and are typically classified within Level 2 of the fair value hierarchy.

Certain OTC derivatives trade in less liquid markets with limited pricing information, or required model inputs which are not directly market corroborated, which causes the determination of fair value for these derivatives to be inherently more subjective. Accordingly, such derivatives are classified within Level 3 of the fair value hierarchy. The valuations of less standard or liquid OTC derivatives are typically based on Level 1 and/or Level 2 inputs that can be observed in the market, as well as unobservable Level 3 inputs. Level 1 and Level 2 inputs are regularly updated to reflect observable market changes.

Level 3 inputs are only changed when corroborated by evidence such as similar market transactions, pricing services and/or broker or dealer quotations. The Company conducts its non-hedging derivatives activities in three main areas: investment related derivatives, credit derivatives and other non-investment related derivatives.

All other assets categorized under sundry assets are recorded at fair value in line with US GAAP.

**Deferred tax assets and liabilities** are recognized in relation to all assets and liabilities that are recognized for solvency or tax purposes in conformity with US GAAP principles adopted by the insurer. Notwithstanding above, the Company values deferred taxes, other than deferred tax assets arising from the carry-forward of unused tax credits and the carry-forward of unused tax losses, on the basis of the difference between the values ascribed to assets and liabilities recognized and valued in accordance with the requirements of the Economic Balance Sheet and the values ascribed to assets and liabilities as recognized and valued for tax purposes.

A positive value is only ascribed to deferred tax assets where it is probable that future taxable profit will be available against which the deferred tax asset can be utilized, taking into account any legal or regulatory requirements on the time limits relating to the carry-forward of unused tax losses or the carry-forward of unused tax credits.

**Intangible assets** Intangible assets are assets other than financial assets that lack physical substance. Goodwill is valued at nil in the EBS. The Company's indefinite lived intangible assets do not meet the definition of intangible assets under EBS and therefore eliminated. Other intangible assets are carried at their fair value where all of the following conditions are met:

- they can be sold separately
- the expected future economic benefits will flow to the company
- the value of the assets can be reliably measured.
- there is evidence of exchange transactions for the same or similar assets indicating that they are saleable in the market place.

**Collateral Loan:** The Company hold an interest free loan which recorded at fair value in line with US GAAP and EBS.

## **D.2. Valuation bases, assumptions and methods used to derive the value of technical provisions**

### **D.2.1 Valuation Bases, Assumptions and Methods to Derive the Value of Technical Provisions**

Technical Provisions are valued based on best estimate cash flows, adjusted to reflect the time value of money using risk-free discount rate term structures with appropriate illiquidity adjustments. In addition, there is a risk margin to reflect the uncertainty inherent in the underlying cash flows which is calculated using the cost of capital approach and risk-free discount rate term structures. The discount rate term structures are prescribed by the Bermuda Monetary Authority for each reporting period.

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

- Unwinding of discounting permissible under GAAP (e.g. Periodic Payment Orders and Workers' Compensation);
- Incorporation of expected reinsurance counterparty defaults (bad debt);
- Incorporation or the identification of events not in data ("ENID") as appropriate;
- Other adjustments related to the consideration of investment and operating expenses, etc.; and
- Discounting credit.

The best estimate for the premium provision is calculated by using the gross unearned premium reserve on a GAAP basis, and then performing a series of adjustments:

- Gross and ceded premiums on already obliged but yet to incept business;
- Applying expected future gross loss ratios;
- Reinsurance recoveries (less bad debt);
- Future Losses Occurring During ("LOD") reinsurance cost covering existing incepted policies;
- Incorporation or the identification of events not in data (ENID) as appropriate;
- Future premiums (payables and receivables);
- Other adjustments related to the consideration of investment and operating expenses, etc.;
- Adjustments for lapses as appropriate;

- Discounting credit.

In the valuation of the non-life (re)insurance obligations within the technical provisions, the Company has used the BMA prescribed risk-free discount rate curves by currency. For the life insurance obligations, the Company has used the BMA "standard approach" to illiquidity premium adjustment to the risk-free discount rate curve, also by currency.

At December 31, 2016, the total net Technical Provisions within the Condensed Consolidated Financial Statements amounted to \$5,980 million comprising the following (reported in USD thousand units):

	<b>Total USD 000's</b>
Claims Provision	5,784,835
Premium Provision	(290,641)
Risk Margin	486,400
<b>Total Technical Provisions</b>	<b>5,980,594</b>

### **D.2.2 Uncertainty/limitations Associated with the Value of the Technical Provisions**

There is an inherent uncertainty in the estimates as there is in any estimate of claim reserves. We expect that actual future losses will not develop exactly as projected and may potentially vary significantly from our projections as actuarial indications are subject to uncertainty from various sources, including but not limited to changes in claim reporting patterns, claim settlement patterns, judicial decisions, legislation, and general economic conditions. This uncertainty stems from several factors including lack of historical data, uncertainty with regard to claim costs, coverage interpretations and the judicial, statutory and regulatory provisions under which the claims may be ultimately resolved. Further, our projections make no provisions for extraordinary future emergence of new classes of losses or types of losses not sufficiently represented in the historical data or that are not yet quantifiable.

### **D.3. Description of recoverables from reinsurance contracts**

The reinsurance recoverables for the claims provisions are sourced directly from the GAAP submissions.

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

The balance is adjusted for counterparty credit rating based on rating agency and default statistics.

### **D.4. Valuation bases, assumptions and methods used to derive the value of other liabilities**

Insurance and reinsurance balances payables are measured at amortized cost under US GAAP and are not discounted. There is no difference under the EBS as undiscounted amortized cost is deemed a reasonable proxy for fair value, given the short term nature of these liabilities. Reinsurance payables have been transferred to technical provisions under EBS and therefore there is no impact on capital for this adjustment (apart from an immaterial amount due to the discounting of RI premium payables within technical provisions).

**Derivative liabilities** are measured at fair value under both US GAAP and EBS.

**Payables (trade, not insurance)** are held at amortized cost under both US GAAP and EBS given that this is deemed a reasonable proxy for fair value given the short term nature of this liability.

**Contractual Liabilities Other Than Technical Provisions** All contractual liabilities are recognised on the EBS. Contractual liabilities are valued consistent with GAAP. In cases where the GAAP principles do not require fair value, the insurer should value the contractual liabilities using the EBS valuation hierarchy.

Where the Authority has issued a direction under sections 6C or 56 of the Insurance Act to effectively allow an Insurer to treat a contractual liability as capital in its Statutory Financial Returns, rather than as a liability as GAAP would dictate, then a similar treatment may be adopted for the EBS.

**Current tax liabilities or assets** are measured at the amount expected to be paid to or recovered from the taxation authorities, using the tax rates that have been enacted or substantively enacted by the end of the reporting period.

**Funds held under reinsurance contracts** (whether affiliate or not) are recorded at fair value in line with US GAAP.

**Commissions, Expenses, Fees and Tax Payable** Unearned Commission are costs relating to contractual commissions earned on reinsurance ceded. Under US GAAP these costs are deferred to the extent that they are expected to be recovered out of future margins in revenues on these contracts. Unearned Commission are implicitly included in the premium provisions valuation and not reflected as an asset in the EBS.

**Amount due to Affiliates** Amounts due from parent and affiliates are in respect of payable amounts due to and from companies within the XL Group Ltd. group of companies. The balances arise as a result of the Company's operating and investing activities. There are no fixed repayment terms and all amounts are due on demand and are non-interest bearing. These balances are recorded at fair value in line with US GAAP.

## D.5. Other material information

For the year ended December 31, 2106, there is no other information relating to business and performance required to be disclosed for purposes of this Financial Condition Report.

## E. Capital Management

This section provides particulars regarding an assessment of capital needs and regulatory capital requirements.

### E.1. Eligible Capital

#### E.1.1. Capital management policy and process for capital needs, how capital is managed and material changes during the period

Catlin Insurance Company Ltd 's Capital Management process is aligned with XL Group's.

XL Group Ltd has an overarching Capital Management process to ensure an appropriate level and form of capital. Thereby, the Group's capital position is benchmarked against its projected risk exposures to ensure that it is adequate to support planned business operations as well as certain stressed loss events. The form of the capital is designed to provide a balance between security, flexibility and liquidity.

In addition, the Company ensures that it meets the appropriate levels/standards as defined under the Insurance Act using the economic balance sheet framework to derive the Company's statutory economic capital and surplus, its enhanced capital requirement and its target capital levels as defined therein. There are appropriate levels of oversight from the Board, Risk Management Compliance, Finance and Group Treasury to ensure appropriate capital levels are managed and maintained.

#### E.1.2. Eligible capital categorised by tiers in accordance with the Eligible Capital Rules

<b>Eligible Capital</b>	<b>USD '000s</b>
Tier 1	2,375,456
Tier 2	24,826
Tier 3	0
<b>Total</b>	<b>2,400,282</b>

The Tier 1 capital comprises fully paid common shares, the contributed surplus and perpetual preferred shares. The Tier 2 capital is the difference between encumbered assets for policyholder obligations and policyholder obligations deducted from Tier 1.

### **E.1.3. Eligible capital categorised by tiers in accordance with the Eligible Capital Rules used to meet the Enhanced Capital Requirement (ECR) and the Minimum Margin of Solvency (MSM) requirements of the Insurance Act**

	<b>Limits</b>	<b>MSM</b>	<b>ECR</b>	<b>Minimum Margin of Solvency</b>	<b>Enhanced Capital Requirement</b>
				USD '000	USD'000
Tier 1	Min	80%	60%	2,375,456	2,375,456
Tier 2	Max	20%	40%	24,826	24,826
Tier 3	Max		15%	-	-
<b>Total</b>				2,400,282	2,400,282

Tier 1 capital consists of fully paid common shares and contributed surplus, while Tier 2 reflects the difference between encumbered assets for policyholder obligations and policyholder obligations deducted from Tier 1.

### **E.1.4. Confirmation of eligible capital that is subject to transitional arrangements**

The Company's preference shares are grandfathered as Tier 1 Basic Capital until 1st January, 2026.

### **E.1.5. Identification of any factors affecting encumbrances affecting the availability and transferability of capital to meet the ECR**

The Capital to meet the ECR is available and transferable

### **E.1.6. Identification of ancillary capital instruments that have been approved by the Authority**

For the year ended December 31, 2106, there is no other information relating to business and performance required to be disclosed for purposes of this Financial Condition Report.

### E.1.7. Identification of differences in shareholder's equity as stated in the financial statements versus the available statutory capital and surplus

The starting point to determine available statutory capital and surplus is to prepare the Company balance sheet on an Economic Balance Sheet ("EBS") basis. The EBS balance sheet is derived from the US GAAP balance sheet by making adjustments to reflect the EBS basis of assets and liabilities. This EBS then provides the available capital and surplus which is then categorized into the three ECR tiers. There are restrictions on the amount of Tier 2 and Tier 3 capital which can be used to meet the ECR, as well as the minimum solvency margin ("MSM").

USD '000	
<b>Condensed Consolidated Total Shareholder's Equity</b>	<b>\$3,284,100</b>
Less: Adjustments for Technical provision and Risk Margin under EBS rules	1,328,757
Less: Deferred Acquisition Cost	(953,322)
Less: Other Goodwill & Intangibles	(87,624)
Less: Prepaid Expenses	(10,349)
<b>Statutory Consolidated Total Shareholder's Equity</b>	<b>\$3,561,562</b>

## E.2. Regulatory Capital Requirements

### E.2.1. ECR and MSM at the end of the reporting period

The Company's Minimum Margin of Solvency and Enhanced Capital Requirements as at December 31, 2016 are as follows:

USD '000	Amount	Statutory Economic Capital & Surplus	Ratio
Minimum Margin of Solvency	415,933	3,561,562	856%
Enhanced Capital Requirement	1,663,732	3,561,562	214%

### E.2.2. Identification of any non-compliance with the MSM and the ECR

None

### E.2.3. A description of the amount and circumstances surrounding the non-compliance, the remedial measures and their effectiveness

Not Applicable

### E.2.4. Where the non-compliance is not resolved, a description of the amount of the non-compliance

Not applicable

### **E.3. Approved Internal Capital Model**

#### **E.3.1. Description of the purpose and scope of the business and risk areas where the internal model is used**

Not applicable

#### **E.3.2. Where a partial internal model is used, a description of the integration with the BSCR Model**

Not applicable

#### **E.3.3. Description of methods used in the internal model to calculate the ECR**

Not applicable

#### **E.3.4. Description of aggregation methodologies and diversification effects**

Not applicable

#### **E.3.5. Description of the main differences in the methods and assumptions used for the risk areas in the internal model versus the BSCR Model**

Not applicable

### **E.4. Description of the nature and suitability of the data used in the internal model**

Not applicable

### **E.5. Other material information**

Not applicable

## **F. Subsequent Events**

None

### **F.1. Description of the significant event;**

Not applicable

### **F.2. Approximate date(s) or proposed timing of the significant event**

Not applicable

### **F.3. Confirmation of how the significant event has impacted or will impact, any information provided in the most recent financial condition report filed with the Authority**



Not applicable

#### **F.4. Other material information**

Not applicable

#### **Appendix 1 – Group Structure Chart**