Standard Club

By your side

The Standard Club Ltd

Financial Condition Report (FCR) 2020

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INTRODUCTION

The Standard Club Ltd was incorporated in Bermuda on 5 February 1970, and is licensed as a Class 3A insurer by the Bermuda Monetary Authority. The Standard Club Ltd (the "club") is a mutual association and provides marine Protection and Indemnity ("P&I") and related covers to its members. The club also participated in the Lloyd's market through The Standard Syndicate 1884 ("Syndicate 1884") which was sold on 16 March 2020.

The club's 100% subsidiary, Standard Reinsurance (Bermuda) Limited ("Standard Re") reinsures 90% of the business of the club's underwriting subsidiaries (The Standard Club UK Ltd, The Standard Club Asia Ltd and The Standard Club Ireland DAC). As Standard Re represents a substantial part of The Standard Club Ltd's financial result this Financial Condition Report is applicate to Standard Re.

This report covers the Business and Performance of the Company, its System of Governance, Risk Profile, Valuation for Solvency Purposes and Capital Management.

The club's financial year runs to 20 February each year and reports its results in US dollars.

DECLARATION STATEMENT

To the best of our knowledge and belief, the Financial Condition Report fairly represents the financial condition of The Standard Club Ltd and Standard Reinsurance (Bermuda) Limited in all material respects.

Andrew McComb

Group Compliance Officer

Date: August 12, 2020

I. BUSINESS AND PERFORMANCE

a. **Name**

The Standard Club Ltd

b. **Insurance and group supervisor**

Bermuda Monetary Authority
BMA House
43 Victoria Street
Hamilton
Bermuda

c. **Auditors**

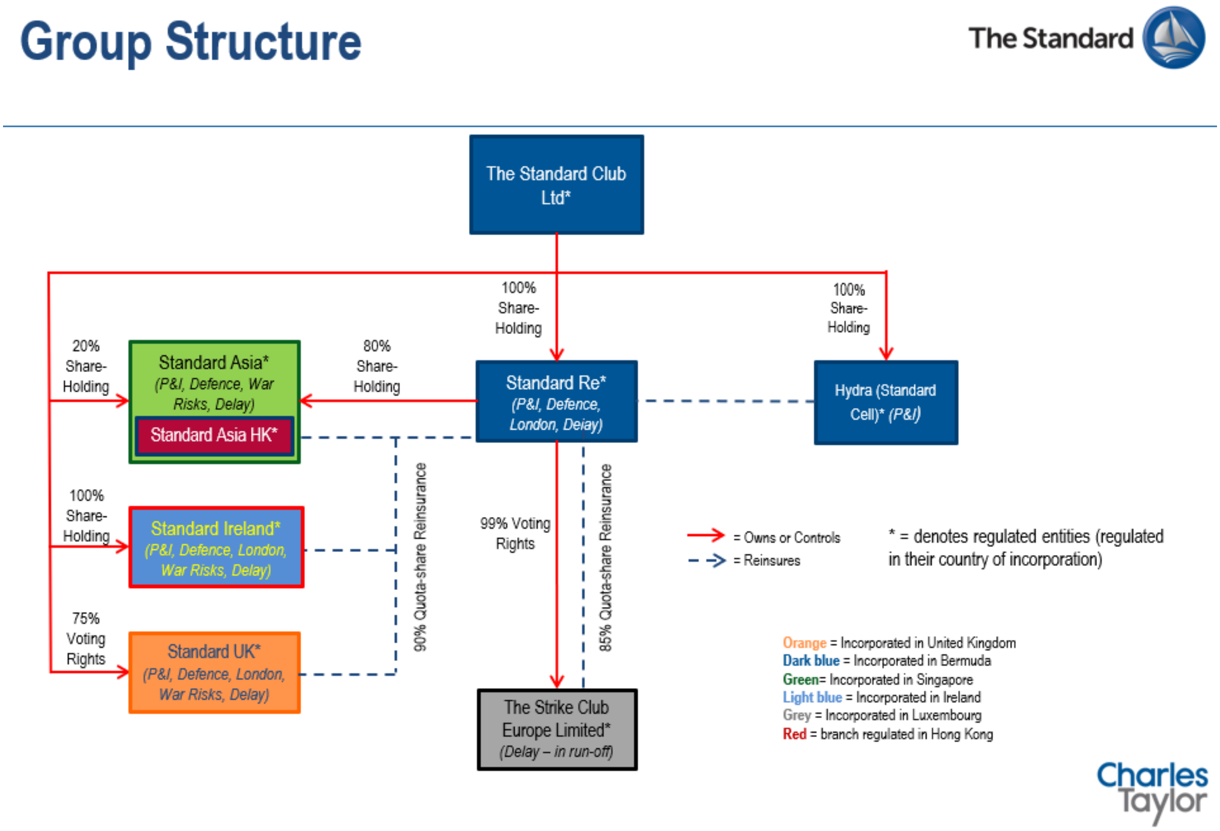
BDO LLP
150 Aldersgate Street
London
EC1A 4AB
United Kingdom

d. **Ownership details**

The club is a mutual association and is therefore owned and governed by its members. Members share risk and operate on a non-profit-making basis. The board of directors is primarily drawn from the membership.

e. **Group structure**

The Standard Club Group ("group") structure chart is shown below.



f. **Insurance business written by business segment and by geographical region**

The principal activities of the group are the insurance and reinsurance of P&I and related risks, war risks, and defence risks, on behalf of its members. The group also participated in the Lloyd's market through its share of Syndicate 1884.

Business Segments	2020 Gross Premium Written (US$ '000)	2019 Gross Premium Written (US$ '000)
P&I related	**271,200**	304,600
Syndicate	**24,900**	114,500
Total	**296,100**	419,100

The group insures ship owners located internationally; the material geographical areas where it insures risks are Europe and North America. The club's subsidiary, The Standard UK Ltd ("Standard UK"), is registered as an alien insurer in New York State, permitting it to write surplus lines insurance throughout the United States. Standard UK operates in countries outside of the European Union and Asia Pacific. The Standard Club Ireland DAC ("Standard Ireland") provides insurance on a freedom of services basis throughout the European Union and European Economic Area. The club operates in the Asia Pacific region through another subsidiary, The Standard Club Asia Ltd ("Standard Asia") and its Hong Kong licensed branch.

BMA Geographical Zones		2020 Gross Premium Written (US$ '000)	2019 Gross Premium Written (US$ '000)
Zone 1	Central & Western Asia	**20,849**	27,754
Zone 2	Eastern Asia	**26,792**	42,389
Zone 3	South and South-Eastern Asia	**30,534**	39,872
Zone 4	Oceania	**3,456**	5,567
Zone 5	Northern Africa	**2,179**	2,920
Zone 6	Southern Africa	**3,058**	3,987
Zone 7	Eastern Europe	**5,302**	7,103
Zone 8	Northern Europe	**18,828**	27,348
Zone 9	Southern Europe	**65,849**	97,047
Zone 10	Western Europe	**63,619**	89,486
Zone 11	Northern America (Excluding USA)	**11,928**	18,092
Zone 12	Caribbean & Centeral America	**2,403**	3,220
Zone 13	Eastern South America	**1,925**	2,435
Zone 14	Northern, Southern and Western South America	**4,430**	4,206
Zone 15	North-East United States	**14,891**	20,167
Zone 16	South-East United States	**11,816**	16,353
Zone 17	Mid-West United States	**304**	407
Zone 18	Western United States	**7,938**	10,748
Total		**296,100**	419,100

g. **Performance of investments and material income & expenses**

Performance of investments

In the year to 20 February 2020, the group's total investments returned 9.7% (2019: 2.2%). The investments include assets in the investment portfolio and the club's share in Syndicate 1884.

Investments	**2020 Balance (US$ '000)**	**2020 Return (US$ '000)**	**2020 Return (%)**	2019 Balance (US$ '000)	2019 Return (US$ '000)	2019 Return (%)
Corporate bonds	**342,056**	**32,441**	**3.73%**	265,898	2,944	0.35%
Sovereign bonds including bills	**328,147**	**24,265**	**2.79%**	334,471	10,429	1.24%
Equities	**108,264**	**4,523**	**0.52%**	98,007	2,439	0.29%
Alternatives	**98,444**	**14,698**	**1.69%**	74,081	925	0.11%
Gold	**-**	**-**	**0.00%**	-	2,691	0.32%
Cash/FX forwards	**10,279**	**(1,131)**	**-0.13%**	33,363	4,458	0.53%
Charles Taylor Shares	**-**	**9,393**	**1.08%**	17,489	(5,719)	-0.68%
Share of Syndicate 1884 investments	**19,380**	**(289)**	**-0.03%**	15,273	133	0.02%
Total	**906,570**	**83,900**	**9.65%**	838,581	18,300	2.18%

Assets highlighted grey in the table above are those within the investment portfolio. The investment portfolio made a return of 8.6% (2019: 2.8%). All asset classes made positive contributions to the portfolio return during the period.

On 30 January 2020, the club sold its holding in Charles Taylor plc shares for $27.1m.

Material income and expenses

The group's main revenue source is premium income. However, as a mutual insurance company, the club does not aim to make underwriting surpluses and instead its goal is break-even underwriting with investment returns used to strengthen the club's capital base.

For the 2019/20 financial year, the group achieved a financial year combined ratio of 131% (2018/19: 113%). This includes the club's share of Syndicate 1884. No return of poolable premiums were made during the 2019/20 financial year (2018/19 financial year: no return) (poolable premium being variable premium on which an unbudgeted call could be made). The group's free reserves stood at $393.7m at the year-end (2019: $434.7m).

The group's major expense arises from insurance claims. There was an increase in the number of new large losses during the 2019/20 financial year. There were five new International Group ("IG") pool claims on the 2019/20 policy year. On average the group would normally expect to have between two to three pool claims a year. This increase was partially offset by the reduction of claims and reserve releases on older policy years.

The decrease in net operating expenses to $58.1m (2019: $81.1m) is largely driven by the club's participation in Syndicate 1884 which ceased underwriting from 1 January 2019 and has been operating in run-off since.

Expense type	**2020 (US$ '000)**	2019 (US$ '000)
Claims incurred, net of reinsurance	**309,100**	274,100
Net operating expenses	**58,100**	81,100
Total	**367,200**	355,200

h. **Any other material information**

Management of the club

The day to day management of the club is outsourced to Charles Taylor and Co (Bermuda) (“the managers”). The managers’ ultimate holding company, Charles Taylor plc, was acquired by Lovell Minnick Partners LLC and became Charles Taylor Limited (“CT”) on 21 January 2020. The acquisition does not impact the current arrangement with the club and the managers will continue to provide its services according to the management services agreement currently in place. The outsourced management of the club and its subsidiaries by the managers and its predecessor companies has existed since the establishment of Standard Club in 1884. The club has no direct employees, with all staff being provided by the managers. Since the year end this operating model has been reviewed by CT and the club and an agreement reached to bring the majority of management services currently supplied by CT in-house. Further information is provided in section g. Outsourcing in chapter II. Governance Structure.

International Group of P&I clubs

The club is part of the International Group of P&I clubs (“IG”), made up of 13 mutual P&I clubs who between them insure approximately 90% of the world’s ocean going shipping. The IG pool (or share) large claims between them (currently claims excess of $10m are pooled), and collectively the IG purchase external reinsurance once these pooled claims exceed $100m.

UK exit from the European Union

The UK Prime Minister secured the passage of his Withdrawal Agreement Bill in December 2019 and UK formally left the EU on 31 January 2020 following ratification of a withdrawal agreement. The UK has now entered into a transition period that is scheduled to end on 31 December 2020. Whilst negotiations are on-going, it is likely that UK companies could lose ‘passporting rights’ which means that UK insurance companies (including Standard UK) will lose the automatic right to offer insurance to EU insureds. In this respect, the Standard Club Ireland DAC was established to ensure that previous EU members of Standard UK will be able to continue to be insured by the Standard Group. This subsidiary started to write EU risks previously insured by Standard UK from the February 2019 renewal. Standard UK continues to insure its existing non-EU business with its historic EU liabilities in run-off. The board has resolved to undertake a part VII transfer of its historic business (including EU liabilities) into Standard Ireland during 2021. The level of service and cover offered to members (both EU and non-EU) has not been affected by these changes, and has not impacted on the financial security of the wider group.

Principal risk carrying subsidiaries

Standard UK, Standard Ireland and Standard Asia, have in place a 90% quota share reinsurance arrangement with a fellow subsidiary, Standard Reinsurance (Bermuda) Limited (“Standard Re”).

Standard Re holds 69% of the investments of the group (2019: 75%), has 70% of the net assets (2019: 86%), holds 71% of the net claims (2019: 58%), and has 66% of the net premium of the group (2019: 54%).

Sale of subsidiary and investment in associate

The sales of the club’s subsidiary The Standard Club Corporate Name Limited (“SCCN”) and the club’s holding in Charles Taylor Managing Agency Limited were approved by the UK regulators, the Prudential Regulatory Authority, on 5 March 2020, with the sale completing on 16 March 2020. The board considers the transactions as adjusting events after the end of the reporting period and therefore have recognised the financial effects of the sale in the 20 February 2020 financial statements. The provision for loss on disposal of SCCN is $(7.8)m. The removal of net assets of SCCN as at 20 February was $11.8m. The proceeds on sale was $4.0m.

COVID-19

The directors have been monitoring the development of the impact of COVID-19, both directly on the club's business, and indirectly through the development of government policy and advice. The main considerations are as follows:

1) Operational

The club's managers have activated full business continuity contingency plans and now prove that the club can continue to operate in the event of a serious prolonged incident, such as the present pandemic. Business records and documentation are stored electronically, are regularly backed-up and are accessible remotely from anywhere in the world. Personnel in each of the managers' global offices have successfully transitioned to working from home and the club has been able to continue to provide the same level of service to its members.

2) Risks underwritten

The club insures only limited aspects of the effects of COVID-19. The marine protection and indemnity (P&I) policies which form the majority of the club's book provide cover for crew illness and death, crew repatriation and substitution, passenger illness and death, broader liabilities to passengers arising out threats to life, health or safety on board, third-party illness and death and additional quarantine expenses. The club also provides legal expenses cover for members (Defence), and cover for COVID-19 related delays. The net aggregate of COVID-19 claims notified up to 30 June 2020 across all classes of business amounted to $5.5m.

3) Investment portfolio

Since the year end the club has removed some of its equity exposure in an effort to de-risk the portfolio. This has mitigated the impact of the volatile investment market on the club's investment return, with the club recording a 0.7% surplus of $5.5m in the period from 20 February 2020 to 30 June 2020.

4) Policyholders

In the likely event of a major downturn in economic conditions, there will be members and business partners of the club who will be affected. The impact on the club in the short term is likely to be pressure on cash flow and on debt recovery, and in addition, in the medium term, in pressure on premium, but there are also likely to be reduced levels of claims due to diminished levels of activity. For most members, P&I insurance is effectively compulsory, but laid-up ships will pay reduced premiums. The managers maintain very close links directly with members and through brokers network, and will respond as necessary as the position develops.

5) Regulators and forecasts

The managers are modelling stressed future scenarios to assess the club's compliance with regulatory capital requirements in the context of the risk appetite determined by the board. The directors recognise that as the foreseeable scenarios change, decisions may need to be made in relation to the scale of the club's activity and the level of capital maintained to support that activity. At the 20 February 2020 year end, the club's BMA Economic Capital and Surplus of $399m was in excess of the club's ECR of $231m. Further information is provided in chapter V. Capital Management. The managers do not expect a significant reduction in the levels of surplus regulatory capital to occur over the next 12 months.

6) Going concern

As at the date of signing these financial statements, the directors' forecasts up to 20 February 2023 indicate that the club will be able to maintain liquidity and a surplus over its Solvency Capital requirement, and will therefore be able to continue to trade as a going concern. Even in severely stressed scenarios the conservative investment portfolio held by the club and the comprehensive reinsurance arrangements in place, will limit the extent of any downside risk. The directors are constantly monitoring the position in case any such stressed scenarios become more likely than is judged to be the case currently, however none would cause any going concern issues.

II. GOVERNANCE STRUCTURE

a. **Board and senior executive**

i. Board and senior executive structure, role, responsibilities and segregation of responsibilities

1) Board

The board of the club comprises 29 directors, of which:

- 25 are drawn from leadership positions within shipping businesses which are insured by the club's subsidiaries;
- Three are non-executive directors with insurance industry experience;
- One is drawn from the managers, being the Chief Executive Officer ("CEO") of the club.

The role of the board is to focus on those tasks that are unique to it as the representative of the members and necessary for it to undertake for the effective promotion of the company's interests. The board will assure itself that the club is achieving the purpose by satisfying itself that the business plan developed by the managers and accepted by the board represents a satisfactory means of progressing the purpose.

2) Board committees

There is a schedule of matters reserved for consideration by the board and the board has established three committees: Audit and Risk Committee ("ARC"), Nomination and Governance Committee ("NGC") and Strategy Committee.

The board and its committees meet at least three times a year. One meeting is held at least every other year in Bermuda, the other meetings are held throughout the world as the majority of the board is comprised of members drawn from the global shipping community.

In addition, a 'Chairman's Group', comprising the chairmen and deputy chairmen of the Standard Club, Standard Asia, Standard Ireland and Standard UK, the chairmen of each committee, and a past chairman review the affairs of the club with the managers between board meetings.

3) Delegation of responsibilities and allocation of functions.

a) Delegation of day-to-day management

The day-to-day management of the club and its subsidiary companies is delegated to the manager by contract under a management agreement.

b) Management Agreement

The management agreement sets out the terms upon which the managers and its affiliated group companies provide management services to the group.

c) Service Level Agreement and Key Performance Indicators

The services provided by the manager are subject to a Service Level Agreement ("SLA") which forms part of, and is subject to, the management agreement. The SLA sets out the key performance indicators ("KPI's") for the club's success and assist the board in its monitoring of the material outsourcing arrangement.

The NGC and the board review the manager's performance against KPIs set out in the SLA on an annual basis.

The manager oversees execution of the day to day management of the club through a number of committees, which include; manager's executive committee, manager's risk committee, manager's regulatory risk committee, and which are comprised of selected management and staff of the manager with appropriate professional qualifications, skills and experience. The manager's executive committee is led by the Chief Executive of the Management Services Division.

The club has appointed the following officer positions from employees of the manager:

Chief Risk Officer

Group Financial Controller

Group Compliance Officer

In addition the managers serve as the Company Secretary.

Each of these officers performs their group responsibilities from the head office in Bermuda and report directly to the club's board and committees as required.

4) Training - an annual program of training is provided to the board and its committees, key function holders and the manager's employees.

5) Internal audit and compliance reviews of management functions are carried out to assess performance against agreed systems and procedures and for effectiveness.

6) Annual appraisal process/board evaluation

As part of the club's governance processes, and in line with good corporate governance practices, the club conducts a periodic board and committee evaluation.

The NGC makes recommendations to the board in respect of enhancements that it considers desirable following its review of the evaluation results. Each January, it considers the progress against actions in respect of improvements identified in the results of the annual evaluation process.

ii. Remuneration policy and practices

Directors' fees (including committees) – The NGC's terms of reference include the review and recommendation of changes to directors' fees. A detailed benchmarking exercise was conducted during 2015 to ensure fees were brought into line with market rates, and a further review was conducted during 2016.

Management fee – Annually in October the manager submits a proposal in respect of the proposed fee to be paid by the club to the manager, for the services provided under the management agreement for the following year, to the NGC. The NGC reviews the fee proposals and makes a recommendation to the board. The NGC in reviewing the fee takes account of the fees paid by the other P&I clubs to their respective management companies and the resources required to execute the company's business strategy.

Remuneration policy - The NGC considers the remuneration policy of the manager to ensure that it aligns with the interests of the club and that it does not promote excessive risk taking. In doing so, it additionally reviews the objectives of the Chief Executive of the Management Services Division in respect of the previous year as well as the prospective objectives of the Chief Executive and selected members of the manager's executive committee. The chairman of the NGC reports to the board on its review of the policy.

iii. Pension or early retirement schemes

As the club does not have employees, there are no supplementary pension or early retirement schemes to disclose.

iv. Material transactions with shareholder controllers, persons who exercise significant influence, the board or senior executives

No transactions occurred during the financial year.

b. **Fitness and proprietary requirements**

i. Fit and proper process in assessing the board and senior executive

The club outsources management of the company and its subsidiaries to a manager, as is the most common operating structure for P&I Clubs across the world. The contract is with the managers who in turn engages other CT group entities. There are two basic groups of roles that can be considered key to the club:

- The Non-Executive Directors of the Club who act as Chair of the Board, Audit and Risk Committee or the Nomination and Governance Committee;
- The manager's executive committee which is comprised of management and staff of the manager with appropriate qualifications, skills and experience in all of the key roles and functions required to effectively operate the club's business and execute its strategy.

There is also a skills and knowledge matrix used by the club to ensure that the board has the right combination of skills, knowledge and experience to meet its regulatory obligations and the firm's strategic and operational objectives.

A Fit and Proper Policy is in place for the club and describes the objectives, roles and responsibilities and governance around the selection, due diligence and appointment of resource into the key roles. The policy is reviewed and approved at least annually.

ii. Board and senior executives' professional qualifications, skills and expertise

The board is drawn from a cross section of the club's membership, all of whom are senior managers (or owners) in those organisations, plus three non-executive directors with insurance industry expertise, and one executive of the managers. Members of the board are selected based on their professional experience and expertise. The table below outlines the board's areas of expertise.

SYSTEM OF GOVERNANCE	INSURANCE & FINANCIAL MARKETS	BUSINESS STRATEGY & BUSINESS MODEL	REGULATORY FRAMEWORK & REQUIREMENTS	FINANCIAL & ACTUARIAL ANALYSIS	LEGAL	SHIP OPERATIONS
17	10	25	4	12	5	27

c. **Risk Management and Solvency Self-Assessment**

i. Risk management process & procedures to identify, measure, manage and report on risk exposures

1) Risk management system

The risk management system is owned and defined by the board. It is designed to ensure that the risk strategy is consistent with the overall business strategy and operates effectively within its documented risk appetite. The risk management system includes classification of risks in the risk register, assessment of risks in terms of likelihood and impact, and identification of key risk controls and indicators for each risk type. Oversight of the risk framework governance is delegated by the board to the ARC, and formal roles, responsibilities and governance of risk are set out in the scope of individual senior management role descriptions, terms of reference of internal oversight committees and the policies and procedures used within the business.

2) "Three lines of defence" principle

The risk management system follows 'three lines of defence' principles widely used within the insurance industry. Management of risk is performed by business functions on a day to day basis, supplemented by oversight and review of controls by the risk management function and independent assurance that controls are adequate through testing performed by the internal audit department.

3) Risk management function

The risk management function consists of the risk management department and other members of the executive management team involved in oversight of the risk management processes of the business, for example members of the manager's risk committee. The risk management department is responsible for co-ordinating the activities of the risk management function and maintaining a high level of risk management awareness across the business.

4) Risk strategy and appetite

Risk management strategy is subject to a formal strategic risk appetite statement, which sets out the degree of risk considered prudent to accept in the overall long-term interests of the club's stakeholders. Risk appetite and strategy are explicitly linked with the capital management objectives of the Standard Club group and the nature of its mutual ownership and objectives.

The strategic risk appetite statement requires the business to manage its affairs in a manner intended to:

- Reduce the likelihood that it is required to make an unbudgeted supplementary call on its members to an acceptable minimum;
- Target a breakeven underwriting result over the business planning horizon;
- Ensure it maintains delivery of excellent levels of service to members;
- Ensure the degree of risk to which mutual members subject to supplementary calls are exposed from activities other than core underwriting activities (for example, from investments or fixed premium business) is appropriate and commensurate with the expected benefits.

In addition, the business monitors the level of capital held to ensure it is at a level appropriate to allow for the orderly management of its affairs consistent with its mutual objectives, including maintaining its financial strength and external credit rating.

At a more granular level (for example, by risk category) risk appetite is expressed in terms of impact and likelihood using a risk assessment matrix, where the impact is measured as a proportion of free reserves.

5) Risk governance

The ARC and board review the club's risk appetite and risk policies at least annually in respect of the major business risks facing the group, their potential impact, and the systems to manage and mitigate those risks.

Day to day management of risk is the responsibility of the manager's executives as part of the performance of their roles, as set out in individual job descriptions, defined processes and procedures identifying levels of authority within the management structure, and risk policies. The club operates an internal manager's risk committee led by the Chief Risk Officer and including key senior managers, which monitors and provides oversight of risk and capital issues across the business. The risk committee is responsible for making recommendations and ensuring that the manager's executive committee is kept informed of key risk information and issues, and escalating matters of concern to the ARC.

6) Management information

Tools, models and systems have been developed in order to provide qualitative and quantitative management information for use in risk management decisions. In particular, the group makes use of its internal model in order to quantify the levels of aggregate risk carried at both group and entity level and to monitor whether levels of risk are within strategic risk appetite. Detailed measures of the group's appetite for risk have also been established, with key risk indicators reported at each board meeting against pre-set board and management tolerances, for example with respect to key financial ratios, maximum exposure to individual investment counterparties, maximum exposure to specific ship types, or acceptable levels of new business growth.

7) Policies and procedures

Policies and procedures are in place in respect of the material risks of the club which, amongst other matters, set out the roles and responsibilities with respect to the management of risk. Specific processes and procedures are in place to manage risks arising from the business. These are designed to ensure that transactions and decisions are made by individuals with appropriate levels of experience and authority, with consideration of relevant risks.

ii. Risk management and solvency self-assessment systems implementation

1) Strategy and appetite

The risk management function provides significant input into the design and implementation of risk appetite which assists in setting the strategy of the club, for example with respect to the key underwriting and investment risks.

The risk management department co-ordinates the monitoring of whether the club is likely to, or has, exceeded risk appetite and assists in making decisions in those eventualities. The assessment is reviewed by the manager's risk committee on a quarterly basis.

2) Risk assessment and control effectiveness reviews

The risk management department has implemented a rolling program of reviews to assess business risks and the effectiveness of the mitigating controls in place. This program is designed to cover all areas of risk identified in the risk register on a semi-annual basis. These reviews, which are performed in conjunction with each business function, consider whether controls are effective and ensure that outstanding risk mitigation actions are occurring in a timely manner.

3) Incident reporting and embedding risk management

There is an emphasis upon continual education of management and staff in considering good risk management practice in the respective aspects of their roles. The risk management department maintains an incident reporting process which records control failures and "near miss" events and is designed to identify underlying root causes and whether any control improvements can be implemented. Incidents are reported to the executive management committee and to the board.

4) Use of internal model

The risk management system and processes are linked to the club's internal model. The internal model is used to create the financial projections which form the business plan. Key assumptions used in the model reflect expectations of future insured exposure and premium rate changes, claims frequency and severity trends and investment returns. Assumptions with respect to the degree of uncertainty and volatility arising from risk taking activities are based on a combination of analysis performed by the actuarial function and inputs provided by business functions. Internal model assumptions are reviewed by relevant business experts and the ARC. Internal model outputs are a key input into the ORSA process described below, and its uses include assessing levels of risk compared with risk appetite, assessing the adequacy of reinsurance arrangements, and informing pricing and capital management decisions.

iii. Relationship between solvency self-assessment, solvency needs & capital, and risk management

1) Key elements of the Solvency Self-Assessment process (otherwise known as the Own Risk and Solvency Assessment ("ORSA") process).

The ORSA process brings together the key elements of risk, capital and strategy. It is performed at both group and subsidiary level and is summarised in a single annual report which is approved by the board. At a group level the ORSA report meets the Bermuda regulatory requirement to prepare a Commercial Insurers Solvency Self-Assessment report.

The ORSA process combines outputs from business strategy and planning processes with the results of risk profile monitoring, stress and scenario testing and outputs from the internal model on aggregate levels of risk. The annual ORSA report consolidates the results of these analyses in a single document in order to provide a coherent view of capital adequacy, risk profile, the effectiveness of the risk management system and key risk mitigating actions required to ensure the business remains within risk appetite.

In addition, each board meeting receives a summarised "Risk Overview" which sets out the status of key risks to achieving strategic objectives together with actions designed to mitigate these, an assessment of capital adequacy, an analysis of key investment risks, and an analysis of the likely range of outcomes for the current financial year.

2) Financial information and business plan

The prior year results used for financial reporting provide the basis for the first stage of the ORSA and strategic planning processes. The internal model is used to create a business plan over a three year time horizon including projected levels of free reserves and the potential distribution of outcomes around the central projection. These results are used to review the business plan against risk appetite and to amend plans if required.

3) Stress and scenario testing and emerging risk review

The ORSA process includes a pre-defined set of stress and scenario tests. There is a structured annual process to review potential emerging risks which is designed to identify whether any changing or new risk could have a significant impact on the business risk profile, and whether any consequent actions are required (for example, a new risk mitigating action or set of controls). The significance of new or emerging risks is typically assessed through development of appropriate stress tests.

<u>iv. Solvency self-assessment approval process</u>

1) ORSA report governance

The Chief Risk Officer is responsible for the preparation of the ORSA report, including ensuring that it articulates a coherent overall strategic plan that fits with the agreed risk appetite. The board reviews and approves the ORSA report in conjunction with the strategy and business plans. A key expectation is that the ORSA report and strategic and business plans are aligned and fit within strategic risk appetite.

2) ORSA process timing

The ORSA process is continuous, with various elements conducted through the year and integrated into the final ORSA report. For example, internal model outputs are used to inform decisions on potential changes in premium rates for renewals in the following policy year. A draft assessment of capital levels based on internal model outputs incorporating the results of February renewals is provided at the May board meeting.

The final ORSA report is approved annually at the October board meeting. Much of the information that forms part of the final ORSA report is reported to the ARC throughout the year via the regular risk reporting.

Internal Audit perform an independent review of the ORSA report to provide assurance that it has been prepared in line with the board's ORSA policy and is consistent with underlying financial and other information.

d. **Internal controls**

<u>i. Internal control system</u>

The club has a robust system of internal controls which are used to manage the risks faced by the club to within its documented risk appetite. This system covers all functions and all activities undertaken by the managers on behalf of the club.

Business functions (such as underwriting, loss prevention or claims) own the functional controls for their areas of responsibility. These controls are set out in the risk register and described in procedure manuals, often accompanied by process flows to aid the accurate adoption of procedures by new resource.

ii. Compliance function

The Compliance function, supported by Risk and Finance, covers four principal areas:

- Prudential (ensuring solvency and rating agency capital is maintained; regulatory capital is reported and pertinent waivers are maintained);
- Organisational (training and competence; fit and proper of key roles; general governance, including Conflicts of Interest and Data Protection issues)
- Transactional (regulatory reporting; conforming with licensing requirements; maintaining a complaints register; guarding against Financial Crime and screening against sanctioned entities, regions and cargo).
- Advisory (providing and issuing advice to the business on a range of regulatory issue)

The club has a Compliance Terms of Reference document that agrees the role of Compliance in advising the first line on new and ambiguous regulatory issues, monitoring the application of regulatory controls, reporting on findings, as well as training and supporting business change initiatives. The Compliance Terms of Reference are revised annually by the managers Regulatory Risk Committee ("RRC") and by the ARC.

e. **Internal Audit**

i. Implementation of the internal audit function

Internal audit ("IA") prepares, in consultation with risk management, compliance senior management and other key users, an annual audit plan ('the plan'), setting out the proposed timing and rationale for IA assignments. The plan is based on a risk assessment, identifying business objectives, all significant activities and key risks to the achievement of those objectives. The plan is reviewed and approved by the ARC and communicated to the club boards. The ARC satisfy themselves that the plan addresses all key business risks.

Any significant changes to the plan are discussed with the chairman of the ARC and are communicated to the ARC for approval.

ii. Independence and objectivity of the internal audit function

IA is independent of the activities that it audits, and its auditors are objective in performing their work. IA, while consultative in approach, is free from interference in determining the scope of internal auditing, performing work and communicating results. In summary, IA is impartial, unbiased and avoids conflicts of interest.

To ensure independence, IA is directly accountable to the chairman of the ARC, with a day-to-day administrative reporting line to the CEO of CT, and free and unrestricted access to the chairmen of the club boards.

The ARC approve the audit terms of reference and audit plan and material changes to them.

Members of the IA team do not generally perform day-to-day control procedures or take operational responsibility for any part of CT's operations outside IA. CT's management is responsible for the establishment and ongoing operation of the internal control system.

The ARC review the scope and nature of the work performed by IA to confirm its independence and objectivity.

f. **Actuarial function**

The Chief Actuary, a qualified actuary with more than 25 years of general insurance experience, has responsibility for the actuarial function, which:

- contributes to the effective implementation and embedding of the risk management system, in particular by designing, implementing, updating, testing, running and reporting on the internal model;
- calculates and validates the technical provisions;
- assists with the underwriting process by devising and maintaining pricing tools;
- expresses an opinion on the overall underwriting policy;
- uses the internal model to compare proposed reinsurance arrangements;
- expresses an opinion on the adequacy of current reinsurance arrangements;
- reports to the senior management and the board on the reliability and adequacy of actuarial calculations and technical provisions, including a comparison of actual developments with those previously expected;
- liaises with the external auditors to assist with their annual independent assessment of the technical provisions; and
- provides an opinion to regulators on the adequacy of the respective group regulated entities technical provisions.

The Chief Actuary reports to the board three times a year on subjects that as a minimum include the actuarial function reporting cycle, which comprises the setting of GAAP technical provisions, the conversion of GAAP technical provisions to an economic balance sheet (“EBS”) basis, an opinion on the underwriting policy, an opinion on the reinsurance arrangements, and a description of how the actuarial function has contributed to the risk management system during the year (including use of the club’s internal model).

g. **Outsourcing**

<u>i. Outsourcing policy and key functions that have been outsourced</u>

1) Outsourced management of the business

The day to day management of the group is outsourced to the managers. The use of an outsourced manager is an operating model adopted by several other P&I club competitors, having evolved over many years in response to the mutual ownership and specific marine liability management and insurance needs of the ship owners who control the club and for whose benefit it has been established. As a consequence, the club has only one direct employees (the CEO of the Standard Asia Hong Kong branch, who is required under local regulations to be a direct employee), with all other staff being provided by the outsourced manager.

The managers control the outsourced management of the group from Bermuda or procures the performance of activities from other CT entities. Reflecting the wide geographical scope of the club’s business, it procures performance of some activities to other entities within the CT group, the most significant of which are:

- Charles Taylor Investment Management Company Limited – providing investment management services for the group and its subsidiaries.
- Charles Taylor & Co. Limited – providing insurance management services in London, including management of a substantial part of the affairs of Standard UK.
- Charles Taylor & Co (Ireland) - providing insurance management services in Ireland, including management of a substantial part of the affairs of Standard Ireland, and some claims management services on behalf of Standard UK.

- Charles Taylor Mutual Management (Asia) Pte. Limited – providing insurance management services in Singapore, including management of a substantial part of the affairs of Standard Asia, Standard Asia's Hong Kong branch and some claims management services on behalf of Standard UK.

A number of arrangements are in place between the managers and other affiliated CT entities, for example to support claims management activities performed on behalf of Standard UK in its regional offices or where specific ancillary services are performed such as acting as claims correspondent.

The performance of the managers is formally reviewed by the NGC at least annually against the Service Level Agreement detailed within the management agreement which governs the outsourced relationship. The board also exercises oversight of the performance of the managers through the regular reporting provided by the various function heads at each meeting of the board and its committees, through reports provided by the key functions (finance, underwriting, claims, actuarial, risk, finance, compliance and internal audit) and through regular discussion between key board members (for example, the chair of Standard UK and the chairs of the ARC and NGC) and executives.

2) Outsourcing policy

An Outsourcing Policy is in place which considers both:

- The primary outsourcing relationship with the managers and other CT group entities which have been delegated responsibility to provide management services to members of the group.
- The approach to be taken in the event that the managers themselves outsource activities that would otherwise be performed directly by them.

The outsourcing policy sets out a number of requirements with respect to outsourcing arrangements including:

- No activity or function reserved for the board may be outsourced. In addition, if the function or activity is considered critical or important (for example, insurance product design and pricing, performance of key functions such as actuarial), the board must authorise any further outsourcing arrangement proposed by the managers.
- Notification of material outsourcing arrangements to regulators where required.
- Criteria which must be considered in selecting a new outsourced provider or renewing an existing contract, including the ability of the provider to provide services in a manner that will not breach risk appetite and will meet business continuity standards and regulatory requirements.
- Prescribed elements to be included in written contractual arrangements.
- Contingency plans in the event the service provider is unable to deliver an adequate level of service or seeks to terminate the outsourced arrangement.

3) Future developments

Since the year end Charles Taylor and the Standard Group have reviewed the current outsourcing arrangements and have agreed to bring the majority of the managements services currently supplied by Charles Taylor in-house (a process likely to complete in later 2021). Charles Taylor will continue to supply services in the future, albeit on a reduced scale, and is likely to include IT support, investment management, property management and internal audit. The club's outsourcing policy will be revised over the next year in light of these changes.

ii. Material intra-group outsourcing

There are no material intra-group outsourcing arrangements between the entities of the Standard Club group .

h. **Other material information**

No other material information to report.

III. RISK PROFILE

The group's main risk categories are underwriting, market, credit, liquidity and operational risks. To maximise the efficient use of capital within the group Standard Re retains 90% of the underwriting, credit, liquidity and operational risk of the core P&I business and related covers, and holds the majority of the investment assets of the group. As a result, while the following risks are set out at group level, they also apply to the principal group risk carrier, Standard Re.

A. UNDERWRITING RISK

a. **Material underwriting risks**

1) The underwriting risk of the club arises from two main categories of insurance product which it provides to its members:

- "Poolable" P&I cover – being protection and indemnity insurance which covers members against third party liabilities arising from their shipping activities.

  "Poolable" P&I represents covers which qualify for inclusion within the International Group ("IG") pooling agreement. The IG is made up of 13 principal mutual P&I clubs which are owned and controlled by ship owners representing approximately 90% of the world's ocean going ship tonnage. Each club (including The Standard Club) pools losses in excess of a $10 million per claim retention, with losses in excess of this amount being shared between all clubs using a formula based on historic loss record of each club and the tonnage and type of ships entered into the pool. The IG has entered into a number of collective reinsurance arrangements with the commercial reinsurance market, which takes a progressively greater share of individual losses as claim size increases. Losses in excess $2.1 billion (termed "overspill claims") are re-pooled, however the IG reinsurance arrangement provides an additional $1 billion reinsurance for a single claim. In practice no claim has yet arisen which breached the limits of the IG reinsurance programme, with the largest individual poolable claim to date being $1.48 billion of third-party liability costs arising from the wreck of the Costa Concordia.

  Poolable P&I cover is a variable premium product, meaning that the club may make supplementary calls on members if required to meet unanticipated financial losses. All clubs which are members of the IG must be mutual associations capable of levying additional premiums on their members in the event that an overspill claim occurs. In practice, as set out in the club's risk appetite statement, the business seeks to minimise the possibility that such unbudgeted supplementary calls could occur.

  As a consequence of the pooling arrangement the club is subject to underwriting risk arising from both its own policyholders and through its share of other P&I club's poolable claims ("inwards pool" claims).

- "Non-pool" business – being either protection and indemnity insurance where the nature of the underlying activity does not qualify for inclusion in the IG pooling arrangement (primarily relating to offshore energy activities), liability cover for ship charterers, or ancillary covers such as legal expense costs relating to shipping disputes.

In addition to the benefit provided by the IG pooling agreement, the club benefits from specific per claim reinsurance for non-poolable risks and stop-loss reinsurances provided by commercial reinsurers.

2) Categorisation of types of underwriting risk

At a high level underwriting risk is categorised between premium risk, being the risk that premiums will not be sufficient to meet all claims covered and associated expenses, and reserve risk, being the risk that case or actuarial reserves will be inadequate in covering known or unreported losses. These risks are further considered in terms of:

- Inappropriate insurance strategy, including reinsurance strategy;
- Ineffective implementation of underwriting strategy;

- Ineffective implementation of reinsurance strategy;
- Ineffective claims management, leading to inappropriate case reserve and settlements;
- Inadequate actuarial reserving.

b. **Risk mitigation techniques**

A number of risk mitigation techniques are used to manage underwriting risk, including:

1) Premium risk

- Board and senior management review of underwriting results, drafting of strategy and business plans;
- Reinsurance strategy is reviewed and monitored by the board in line with risk appetite;
- Comprehensive and high quality reinsurance programme;
- Underwriting and reinsurance authorities, approvals, processes, reporting and review;
- Programme of peer reviews and other technical file reviews;
- Use of exposure based pricing tools for new business;
- Activities of the loss prevention department, including ship surveys, member risk reviews, and application of coverage warranties, exclusions or non-renewal of members where ship operating standards are considered deficient;
- Monitoring for undue concentrations of risk and acceptability of results consistent with risk appetite.

2) Reserve risk

- Claims case management: authorities, approvals, processes, reporting and review;
- Systems workflow in place to assist management of claims cases;
- Claims peer review, feedback and management information;
- Actuarial reserving: modelling processes, reporting and review;
- Board: review and approval of key reserving output.

c. **Material risk concentrations and changes in risk profile over the reporting period**

Gross underwriting risk decreased over the reporting period mainly due to the club's share of the Syndicate 1884 which stopped underwriting new business from 1 January 2019 and was subsequently sold on 16 March 2020. This decrease was slightly offset by an increase in underwriting risk pertaining to the club's own business caused by five large pool losses and an overall increase in attritional claims over the period. Underwriting risk net of reinsurance has moved in line with gross underwriting risk.

The past few years (until 2019/20) have been characterised by a benign claims environment and release of prior year claims reserves. This, coupled with strong balance sheets across the International Group clubs, has resulted in a softening of P&I insurance rates. This period of low claims and reserve releases ended in the 2019/20 financial year, with rate rises seen at the February 2020 renewal and further rises likely at the February 2021 renewal.

More than 90% of net underwriting risk arises from poolable P&I cover, driven largely by the club's exposure to inwards pool claims. While the club monitors other types of underwriting risk concentration, including ship type and membership, these represent less significant sources of concentration risk. P&I cover provides liability cover for ships which are trading on a global basis, therefore the club is not significantly exposed to geographical risk concentrations, for example, compared with insurance of static property or similar asset based covers. As a consequence the primary drivers of underwriting risk relate to:

- The number and severity of large poolable P&I claims including inward pool claims.
- The potential for significant adverse reserve development arising from existing claims or new types of previously unreported liability.

d. **Stress and scenario testing**

The key stress tests identified with respect to underwriting risk relate to:

- Premium risk – a significantly higher than historic average number of large pool claims occurring in the current policy year.

- Reserve risk – reserve deterioration across all years of account due to a systemic reserving issue.

The club is assessed as being within its risk appetite in relation to the above scenarios.

B. MARKET RISK

a. **Material market risks**

1) Market risk relates to the risk of losses on assets held to pay future claims and operating expenses, and losses on surplus assets held for solvency purposes.

The club's investment strategy has been developed with the following objectives:

- To preserve capital for the payment of the club's claims and other liabilities by limiting risk in the portfolio.
- Within the risk tolerance, to maximise the overall returns as measured over rolling three-year periods.

2) Categorisation of types of market risk

Market risk is considered in terms of three categories:

- Inappropriate investment strategy;
- Ineffective implementation of investment policy, strategy or investment rules;
- Ineffective management of investment counterparties.

b. **Risk mitigation techniques**

A number of risk mitigation techniques are used to manage market risk, including:

- The board reviews and approves investment strategy;
- Clear investment guidelines and rules are implemented and monitored, including counterparty limits;
- Investment guidelines require investing widely and in different asset classes to diversify the portfolio;
- Asset–liability matching processes are in place;
- Foreign-exchange matching processes are in place;
- Interest rate risk exposure is measured and controlled through regular review of the appropriate duration;
- Levels of investment risk are monitored using "Value at Risk" techniques which must remain within risk appetite.

c. **Material risk concentrations and changes in risk profile over the reporting period**

As a consequence of the asset allocation strategy and consequent portfolio diversification, material asset risk concentrations are minimised.

Equities and other riskier assets cannot exceed certain prescribed percentage limits as a proportion of the portfolio. In addition, the portfolio has been defensively positioned over the period due to the level of uncertainty and potential for volatility in global equity markets, as such investments in equities are at the lower end of the permitted range.

Despite maintaining the same conservative policies, as mentioned above, over the period, there is a significant increase in market risk due to the changes in capital charges employed by the BMA in particular around equity risk (with the charge increasing from 14% to 35%) and concentration risk (the concentration risk charge applied to shares has also increased from 14% to 35%).

d. **Investment in assets in accordance with the Prudent Person Principles of the Code of Conduct**

The club invests in a range of assets and instruments whose risks it can sufficiently identify, measure, monitor, manage, control and report, and appropriately consider in the assessment of its overall solvency. All assets are invested to ensure the security, quality, liquidity and profitability of the portfolio as a whole.

Sufficient assets are localised to ensure their availability. Assets are invested in the best interests of the club under the direction of the investment director and in accordance with the club's investment guidelines.

The asset allocation strategy in place reflects a more cautious investment risk appetite for Standard UK, Standard Ireland and Standard Asia than for Standard Re. This focusses on maintaining a portfolio which broadly reflects the liability profile in terms of currency and duration, and consists of a diversified range of investments primarily made up of high quality bonds or similar fixed income instruments. Although some more volatile investments including equities are held within Standard UK, the majority of the Standard Club's higher yield and more volatile assets are held within the Standard Re, which also holds most of the group's capital assets.

These guidelines are reviewed on an annual basis and on an ad-hoc basis if any significant deviations have occurred that affect the financial markets.

e. **Stress and scenario testing**

Investment loss stress tests and scenarios, including consideration of historic scenarios and an inflation shock scenario, are regularly monitored. Standard stress tests include:

- Bond price falls
- Equity market falls
- Currency fluctuations
- Credit spread increases
- Combined bond price and equity market fall

The club is assessed as being within its risk appetite in relation to each of these scenarios.

C. CREDIT RISK

a. **Material credit risks**

Credit risk relates to the risk that another party fails to perform its financial obligations, or perform them in a timely manner. Counterparty risk arises in relation to members, guarantors, other IG clubs, reinsurers, investments and deposits. Under the risk management system investment counterparty risk is considered within the market risk category. Therefore the most significant credit risks arise from reinsurers, banking counterparties used to hold cash and the premium balances due from members of the club.

A diverse range of high quality reinsurers are used on the reinsurance programme.

Significant amounts of money are held with the custodian bank as money flows in respect of premiums, claims and management fees. The flow is carefully monitored and managed so as to not to exceed tolerance levels.

There are a number of credit controls over the possibility of members financial failure, allowing for the club to offset potential losses. The club continues to closely monitor the credit worthiness of members and collect premiums in good time.

b. **Risk mitigation techniques**

A number of risk mitigation techniques are used to manage reinsurer and IG pool reinsurance credit risk, including:

- Reinsurance is placed with many different reinsurers, reducing the potential impact of individual reinsurer default;
- The reinsurance programme is reviewed and approved by the board on an annual basis;
- All reinsurers are required to be hold a credit rating of A- (Standard & Poor's or equivalent) or better;
- The board receives regular reports on the amounts recoverable from reinsurers;

- The IG pooling agreement includes mechanisms to protect member clubs in the event of the default of one of its members, including securitisation of pool recoverables through Hydra Insurance Company Limited, the IG members' captive insurer, and minimum solvency and rating requirements for P&I clubs to be included within the pooling agreement.
- No single reinsurer is able to participate more than 15% on any given layer or in total on the GXL programme.
- No single reinsurer is able to participate more than 15% on the non-pool programme.

Risk mitigation techniques used with respect to the club's banking relationships include:

- Maximum counterparty limits with any single banking entity, which may not exceed $50 million at any time and may not exceed $35 million for more than 5 working days;
- Frequent monitoring of bank credit rating.

Risk mitigation techniques used with respect to the club's exposure to outstanding member premium balances include:

- Under the terms of coverage, member claims may be offset against outstanding premiums.
- Overdue premium amounts are monitored and reported to the manager's executive committee on a monthly basis.
- Member cover can be cancelled for non-payment of premium.
- Guarantor security is monitored by the managers' finance committee.

c. **Material risk concentrations and changes in risk profile over the reporting period**

Reinsurance is placed with a range of highly rated reinsurers, with the highest single concentration being due from underwriters at Lloyd's. The potential overall concentration levels are considered when placing reinsurance and the top 10 exposures are reported to the board.

The club has a small number of key banking relationships for handling cash receipts and payments, which may result in material amounts of cash accumulating for short periods of time, for example when member premium payments are received on key due dates.

The club seeks to maintain a diversified member base, reducing the credit concentration risk to any one member. Given the significant risk mitigation in place, member credit risk is considered to be relatively low.

There has been no material change in risk profile over the period.

d. **Stress and scenario testing**

A regular stress test is performed which considers the impact of the failure of a major reinsurer. The club is assessed as being within its risk appetite in relation to this scenario.

D. LIQUIDITY RISK

a. **Material liquidity risks**

Liquidity risk is the risk of failure to maintain sufficient funds to meet obligations as they fall due, for example due to the lack of marketability of investments, inability to make reinsurance recoveries in a timely manner, and incorporating the risk that additional funding may only be secured at excessive cost.

Given the high level of liquid investments held and mechanisms in place to enable quick access to reinsurance recoveries, the risk is considered to be very low.

b. **Risk mitigation techniques**

A number of risk mitigation techniques are used to manage liquidity risk including:

- Asset-liability matching controls are in place, which assist in the club's ability to manage liquidity;
- The investment rules require a significant proportion of the portfolio to be held in easily realisable assets such as highly liquid sovereign debt;

- The club regularly reviews the time period required to liquidate the investment portfolio;
- Principal reinsurance arrangements allow for short period recovery of all significant claims payments due;
- A monitoring process is in place to identify short term potential cash needs in the business;
- The likely cash outflows in relation to specific large claims are projected and kept under review.

c. **Material risk concentrations and changes in risk profile over the reporting period**

Investment assets are administered by a single asset custodian. While investments are required to be held in segregated accounts, there is a risk that in the event of the failure of the custodian there may be delays in accessing funds in a timely manner.

There has been no material change in risk profile over the period.

d. **Stress and scenario testing**

A reverse stress test is performed which considers a liquidity issue arising from the failure of the asset custodian holding the club's assets, causing significant delays in receipt of funds owed.

The scenario is considered to be very remote and within risk appetite.

E. OPERATIONAL RISK

a. **Material operational risks**

Operational risk is the risk of losses incurred as a result of inadequate or failed internal processes, people and systems, or from external events (including legal risk).

Operational risk is considered in terms of five categories:

- Ineffective management of regulatory or corporate governance requirements;
- Ineffective management of people and relationships;
- Poor data management or application;
- Ineffective management of systems;
- Inadequate planning or reaction to external events.

b. **Risk mitigation techniques**

A number of risk mitigation techniques are in place including:

- Board oversight of service level agreement ("SLA");
- Maintaining professionally-staffed management functions;
- Investment to support recruitment, retention and development of good quality resources;
- Monitoring systems issues, accounting for the need to achieve service objectives and protect data;
- Business continuity planning, including both physical business continuity planning and contingency plans in the event of failure of the outsourced manager;
- Requirement for the managers to maintain errors and omissions insurance;
- Regulatory compliance monitoring.

A system of incident reporting is in place in order to quickly identify operational failings in order that they may be reported upon and improvement actions put in place in order to reduce the risk of reoccurrence.

c. **Material risk concentrations and changes in risk profile over the reporting period**

The club continues to have a strong focus on mitigating the threat from cyber fraud and other cyber related risks. The sophistication of the threat has increased over the period and the club's controls have been strengthened in response.

As of 20 February 2020, approximately half of Standard UK's business renewed in Standard Ireland. Standard Ireland is authorised to carry on insurance business in Ireland and was established to allow the club to continue to serve its EU related business if the UK left the European Union without a deal covering

P&I insurance activity. Operational risk within Standard Ireland has been minimised with the senior management team consisting of existing and experienced employees. Most of the day to day Standard Ireland insurance activity is outsourced to the UK where consistent and well established processes and controls are being applied.

d. **Stress and scenario testing**

A range of operational risk stress and scenario tests are performed in order to understand the potential impact of potential operational issues. The most significant scenarios identified include:

- Rogue investment manager
- Rogue chief financial officer
- Regulator action
- Cyber attack

The club is assessed as being within its risk appetite in relation to the above scenarios.

IV. SOLVENCY VALUATION

a. **Valuation bases, assumptions and methods to derive the value of each asset class**

The club has used the valuation principles outlined by Bermuda Monetary Authority's "Guidance Note for Statutory Reporting Regime" for the reporting period's statutory filing. The economic valuation principles outlined in this document are to measure assets and liabilities on a fair value basis (which is the value that would be received upon the sale of an asset or paid to transfer a liability in an orderly transaction between open market participants at the measurement date). The fair value principles used for the assets are as follows:

- Cash and cash equivalents – these are valued at the amount held at period end date. Foreign currencies are translated at the US dollar rate of exchange at the balance sheet date.
- Investments – these are valued at market price at period end provided by the club's custodian, Northern Trust. The club uses Bloomberg to ascertain that investments are traded in active markets and hold no over the counter assets requiring modelling in the portfolio.
- Accounts and premium receivables – these are valued at cost less any provision for impairment in value. Premium receivable from members recognised as insurance receivables under UK GAAP, forms part of the best estimates technical provision in the EBS. See section b below on the valuation of technical provisions.
- Reinsurance balances receivable – these are valued at cost less any provision for impairment in value.
- Fixed assets - are stated at historic purchase cost less accumulated depreciation. Cost includes the original purchase price of the asset and the costs attributable to bringing the asset to its working condition for its intended use.

b. **Valuation bases, assumptions and methods to derive the value of technical provisions**

The calculation of the technical provisions starts with the GAAP reserves and proceeds in a number of stages:

- Any prudence in the GAAP reserves is removed to arrive at a 'best estimate'.
- An explicit additional allowance is made for events not in data ("ENIDs"): large events that have not happened in the past (so are not in the basic reserves) but might happen in the future.
- An allowance is made for the expenses, both external and internal, of settling the claims. A claims handling expense ("CHE") allowance is already included in the GAAP reserves, however the methodology for calculating this allowance differs under EBS, because it allows for activities of administration, training, management etc. in addition to pure claims settlement activity.
- An allowance is made for reinsurance bad debt. The managers use the credit ratings of the club's reinsurers and default rates published by S&P to estimate the cost of reinsurer defaults over the future lifetime of the claims.
- Reclassification of insurance receivables. Premium debt that is due after the balance sheet date (being the third instalment of poolable premium that is due 9 months after the year-end) is included as a debtor balance in the GAAP balance sheet but forms part of the claims provision on the EBS balance sheet.
- Time value of money. While the GAAP reserves take credit for the time value of money on the asbestos reserves, under EBS discounting is applied to all cash flows for all classes of business.
- 'Premium provisions' are added, on the same basis, for premiums, claims and expenses in respect of future exposures that the club has already agreed to underwrite.
- Risk margin. A risk margin is included to allow for the cost of funding the solvency capital required to support the reserves until they fully run off.

At 20 February 2020, the total Technical Provisions amounted to $625m (2019: $617m) net of reinsurance comprising the following (reported in thousand units):

Technical Provision	**2020 Net (US$ '000)**	2019 Net (US$ '000)
Best Estimate Loss and Loss Expense Provision	**585,029**	517,538
Best Estimate Premium Provision	**(12,073)**	13,690
Risk Margin	**52,447**	85,825
Total	**625,403**	617,052

c. **Description of recoverable balances from reinsurance contracts**

The main elements of the reinsurance recoverable balance are in respect of (a) recoveries on pooled business from the International Group pooling arrangement, which includes recoveries from pool members and from external excess-of-loss reinsurers; and (b) recoveries on non-pooled business from external excess-of-loss reinsurers.

There are no material changes in the relevant assumptions made in the calculation of technical provisions compared to the previous reporting period.

d. **Valuation bases, assumptions and methods to derive the value of other liabilities**

Similar to the valuation principles for assets, the club's liabilities follow the valuations principles outlined by Bermuda Monetary Authority's "Guidance Note for Statutory Reporting Regime".

- Insurance and reinsurance balances payables – these are valued at cost less any provision for impairment in value.
- Accounts payables and accrued liabilities – these are valued at cost less any provision for impairment in value.
- Derivative instruments – these are valued at quoted market prices. In the absence of an active market, prices are based on observable market inputs.
- Any other liabilities – these are valued at cost less any provision for impairment in value. Accrued expenses are included on an accrual basis.

e. **Any other material information**

No additional material information to report.

V. CAPITAL MANAGEMENT

a. **Eligible capital**

i. Capital management policy and process for capital needs, how capital is managed and material changes during the reporting period

The club and board's tolerance for risk is limited by the desire to minimise the chance of making unbudgeted calls on the club's membership, and so the club seeks to maintain sufficient capital such that the chance of a supplementary call or other similar material mitigating action is less than 10% over a 12 month time horizon. Own funds are well in excess of regulatory capital requirements.

In addition one of the club's goals is to provide first class financial security to its membership, including maintaining a 'AAA' capital strength rating with Standard and Poor's, and so any decisions around premium returns or underwriting rate rises are made in the context of ensuring UK GAAP net assets remain above the capital level.

Another goal of the club (which supports maintaining capital strength) is to aim for breakeven underwriting, so ensuring the maintenance of the level of own funds.

There were no material changes during the reporting period.

ii. Eligible capital categorised by tiers in accordance to the eligible capital rules used to meet ECR and MSM requirements of the Insurance Act

At the end of the reporting period, the group's Eligible Capital for its Minimum Margin of Solvency (MSM) and Enhanced Capital Requirement (ECR) was categorised as follows:

Eligible Capital	2020 MSM (US$ '000)	2020 ECR (US$ '000)	2019 MSM (US$ '000)	2019 ECR (US$ '000)
Tier 1	345,557	345,557	284,182	284,182
Tier 2	52,138	52,138	64,421	64,421
Tier 3	-	-	-	-
Total	397,695	397,695	348,603	348,603

The majority of capital is Tier 1, the highest quality capital, consisting of contributed surplus, and statutory surplus. Tier 2 capital consists of ancillary own funds of $51.9m (2019: nil) and a portion of encumbered assets for policy holder obligations that are not collateralised of $0.2m (2019: $64.4m). The reduction in the latter is due to the sale of the club's share of Syndicate 1884 where some of these assets were transferred to the new owners as part of the sale and some were no longer encumbered. Further information on the ancillary own funds is in section v. Identification of ancillary capital instruments approved by the Authority. The group does not have any Tier 3 capital.

iii. Confirmation of eligible capital that is subject to transitional arrangements

There is no eligible capital subject to transitional arrangements.

iv. Identification of any factors affecting encumbrances on the availability and transferability of capital to meet the ECR

None identified.

v. Identification of ancillary capital instruments approved by the Authority

The club's tier two ancillary own funds are $51.9m, recognising the ability of the club to make unbudgeted supplementary calls. The club obtained approval from the BMA for the use of the ancillary own funds on 16 October 2019 for the period from 1 March 2019 to 20 February 2022. The ancillary own funds are calculated as below:

[ETP*M*R], subject to the calculated amount not exceeding 15% of Available Economic Capital and Surplus;

Where:

ETP (estimated total premium) is defined as the amount of mutual premium agreed with the members at inception of each open policy year gross of reinsurance less mutual premium for which release calls have been paid. There are always three open policy years so the calculation applies to all three years;

M is defined as a factor of 0.3 during the current year (first year), 0.25 during the following year (second year) and 0.20 during the year thereafter (third year). These factors reflect the loss absorbing capacity of the ancillary capital;

R is defined as a factor of 0.65. This represents a 0.1 factor deduction for default risk and a 0.25 factor deduction for liquidity risk;

vi. Identification of differences in shareholder's equity as stated in the financial statements versus the available capital and surplus

Differences relate to the impact of employing statutory-based technical provision valuation techniques as summarised below:

Reconciliation - UK GAAP to EBS	**2020 Capital and Surplus (US$ '000)**	2019 Capital and Surplus (US$ '000)
UK GAAP capital and surplus	**393,700**	434,700
Tier 2 ancillary funds	**51,873**	-
Technical provision adjustments (excluding risk margin)	**4,568**	(272)
Risk Margin	**(52,447)**	(85,825)
BMA EBS capital and surplus	**397,695**	348,603

b. **Regulatory capital requirements**

i. ECR and MSM requirements at the end of the reporting period

The group's regulatory capital requirements at 20 February 2020 were assessed as follows:

Requirement	**2020 (US$ '000)**	2019 (US$ '000)
Minimum Margin of Solvency	**82,369**	80,308
Enhanced Capital Requirement	**229,081**	215,231

ii. Identification of any non-compliance with the MSM and the ECR

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

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

Not applicable.

iv. Where the non-compliance is not resolved, a description of the amount of the non-compliance

Not applicable.

c. **Approved internal capital model**

i. Description of the purpose and scope of the business and risk areas where the internal model is used

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

ii. Where a partial internal model is used, description of the integration with the BSCR model

Not applicable.

iii. Description of methods used in the internal model to calculate the ECR

Not applicable.

iv. Description of aggregation methodologies and diversification effects

Not applicable.

v. 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.

vi. Description of the nature & suitability of the data used in the internal model

Not applicable.

vii. Any other material information

Not applicable.

viii. Significant and subsequent events

Not applicable.