

Liberty Specialty Markets Bermuda Limited

**Financial Condition Report
For the year ended December 31, 2021**



Liberty

Specialty Markets

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Introduction

This Financial Condition Report (“FCR”) has been prepared in accordance with the Bermuda Insurance (Public Disclosure) Rules 2015. The FCR is required by law to be made available to stakeholders on their website to provide both qualitative and quantitative information beyond that required by Generally Accepted Accounting Principles. The FCR addresses business performance, governance approach, capital management and solvency, among other matters.

This report includes the results and discussion of Liberty Specialty Markets Bermuda Limited.

All numbers in the report are expressed in thousands of U.S. dollars unless otherwise explicitly stated.

1. BUSINESS AND PERFORMANCE

1.1 Insurer details

Liberty Specialty Markets Bermuda Limited (“LSM Bermuda”) was incorporated under the laws of Bermuda on October 19, 2006. LSM Bermuda, together with its subsidiaries (collectively referred to as the “Company”), began underwriting activities in 2007. LSM Bermuda is registered as a Class 4 insurer under The Insurance Act 1978 in Bermuda, related regulations and amendments thereto (the “Bermuda Insurance Act”).

1.2 Insurance supervisor

The Bermuda Monetary Authority (“BMA”) acts as Insurance supervisor for LSM Bermuda. The contact details for the BMA are as follows:

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

insuranceinfo@bma.bm
1 (441) 295-5278

1.3 Approved auditor

The approved auditor for LSM Bermuda is Ernst & Young Ltd. The contact details for Ernst & Young Ltd. are as follows:

Ernst & Young Ltd.
3 Bermudiana Road
Hamilton HM 08
Bermuda

Cordelia Davis
ernst.young@bm.ey.com
1 (441) 295-7000

1.4 Ownership details

LSM Bermuda was established by an investor group led by Robert Clements, John Clements and 5 private entity firms in December 2006 through a private equity placement of over \$1.03 billion. A further \$300 million private placement investment was completed in July 2009. LSM Bermuda is currently a wholly owned subsidiary of Liberty Mutual Holding Company (“Liberty Mutual”). The acquisition of all stock of LSM Bermuda by Liberty Mutual closed on May 1, 2017.

Liberty Mutual is a diversified insurer with operations in 29 countries and economies around the world. Liberty rank 71st on the Fortune 100 list of largest corporations in the U.S. based on 2020 revenue. As of December 31, 2021, Liberty Mutual had \$156.0 billion in consolidated assets, \$128.2 billion in consolidated liabilities, and \$48.2 billion in annual consolidated revenue. Liberty employs more than 45,000 people in over 900 offices throughout the world and offer a wide range of insurance products and services, including personal automobile, homeowners, accident & health, commercial automobile, general liability, property, surety, workers’ compensation, group disability, group life, specialty lines, reinsurance, individual life, and annuity products.

Since 2020, LSM Bermuda is under governance of GRS North America.

1.5 Group structure chart

See [Appendix A](#) for our corporate structure as of December 31, 2021.

1.6 Insurance business written by line of business and by geographical region

The following table summarizes the Company's gross premiums written by line of business for the years ended December 31, 2021 and 2020:

	2021		2020	
	Gross premiums	Net premiums	Gross premiums	Net premiums written
Casualty	\$157,642	\$92,352	\$122,092	\$76,548
Property	1,628,780	1,612,635	726,288	702,964
Specialty Short Tail	123,011	115,702	298,972	292,757
Total	\$1,909,433	\$1,820,689	\$1,147,352	\$1,072,269

The following table shows an analysis of the Company's gross premiums written by geographical location for the years ended December 31, 2021 and 2020. Certain prior year amounts have been reclassified to conform to the current year presentation.

	Gross premiums written	
	2021	2020
United States	\$1,749,288	\$834,334
Canada	8,133	7,155
Europe	114,382	178,359
Asia Pacific	12,484	8,111
Latin America	2,814	1,402
Other	22,332	117,991
Total	\$1,909,433	\$1,147,352

1.7 Investment performance

LSM Bermuda's investment strategy is focused on delivering stable investment income and total return with maintaining appropriate portfolio liquidity and credit quality to meet the requirements of insureds, regulators and rating agencies. As such, the Company structures its investment portfolio to support the payment of claims and contingent risk exposures with a portfolio of high quality fixed-income investments with a comparable duration profile.

As of December 31, 2021, the fair value of the investment portfolio of LSM Bermuda totaled \$2,002 million (\$2,262 million as of December 31, 2020) and was split by asset class as follows:

	As of December 31,	
	2021	2020
U.S. government and government agency securities	\$303,093	\$254,904
Non-U.S. government securities	-	9,145
U.S. state and municipal securities	112,235	148,700
Corporate and other securities	961,430	1,181,633
Residential mortgage-backed securities	240,947	302,308
Commercial mortgage-backed securities	157,442	143,214
Other mortgage-backed and asset-backed securities	223,526	192,485
Total fixed maturity securities	\$1,998,673	\$2,232,389
Equity securities	460	-
Short term investments	13	3,554
Other investments	3,352	26,142
Total investments	\$2,002,498	\$2,262,085

The value of the Company's fixed maturity portfolio fluctuates with, among other factors, changes in the interest rate environment and in overall economic conditions.

During the years ended December 31, 2021 and 2020, net investment income was derived from the following sources:

	2021	2020
Fixed maturity securities	\$52,365	\$59,298
Other investments	(2,083)	(4,785)
Cash and cash equivalents	52	474
Short term investments	161	257
Total gross investment income	50,495	55,244
Investment expenses	(5,607)	(6,775)
Net investment income	<u>\$44,888</u>	<u>\$48,469</u>

Net investment income was \$44,888 for the year ended December 31, 2021, a decrease of \$3,581 or 7.4% from the year ended December 31, 2020, primarily due to the reduced investment portfolio value as a result of dividends paid of \$300,000 in 2021.

The net realized and unrealized investment loss of \$57,436 for the year ended December 31, 2021 was mainly driven by the steepening of the yield curve with yields increasing by 50bps to 75bps between the 5-year and 10-year parts of the yield curve

Overall, the Company's investment portfolio generated a total return of 2.9% in 2021 compared to 3.6% in 2020.

	2021		2020	
	Market value	Performance, %	Market value	Performance, %
Fixed maturity securities	\$1,998,686	3.0%	\$2,235,943	4.1%
Equity securities	460	0.0%	-	-
Other investments	3,352	-14.1%	26,142	-36.6%
Total	<u>\$2,002,498</u>	<u>2.9%</u>	<u>\$2,262,085</u>	<u>3.6%</u>

1.8 Material income and expenses for the reporting period

The below tables provide summaries of the Company’s material income and expenses line items for the years ended December 31, 2021 and 2020:

	<u>2021</u>	<u>2020</u>
Revenues		
Gross premiums written	\$1,909,433	\$1,147,352
Net investment income	44,888	48,469
Expenses		
Net losses and loss adjustment	1,178,389	585,819
Acquisition expenses	556,612	294,824
General and administrative expenses	14,453	25,822

Gross premiums written increased by 66.4% in the year ended December 31, 2021 compared to 2020.

The increase was primarily attributable to the quota share agreement with Liberty Mutual Insurance Company (“LMIC”), an affiliate entity, whereby LSM Bermuda, effective August 1, 2020, assumes 30% of the Auto Physical Damage (“APD”) business underwritten by LMIC. APD quota share agreement contributed \$927,468, to the increase in the gross written premium in 2021 compared to 2020.

The increase was partially offset by the reduction of the gross premiums written under LMRe brand of \$127,094 primarily due to the lower renewals compared to 2020 for political and credit single risk book, where most of the risks are one off in nature and there is no renewal pattern. Further decrease in gross premiums written under LMRe brand was due to the cancellation of our further participation on certain mortgage deals.

Net losses and loss adjustments expenses increased by 101.2% in the year ended December 31, 2021 compared to 2020, primarily due to the quota share agreement for APD business with LMIC. The Loss ratio for YTD 2021 was 60.5% against the prior year Loss ratio of 52.9%. The travel restrictions during the pandemic contributed to the lower prior year Loss ratio of 52.9%.

The Loss ratio excluding the APD, was 79.6% in the year ended December 31, 2021 compared to 67.1% for 2020. The increase in Loss ratio was primarily due to emerging losses from weather-related catastrophe events, such as Texas Winter Storm Uri, Hurricane Ida and December US Tornadoes.

Policy acquisition ratio for the years ended December 31, 2021 and 2020 was 30.0% and 29.3%, respectively.

General and administrative expenses decreased by 44.0% in the year ended December 31, 2021 compared to 2020. The majority of the decrease was due to the reduction of the operating expenses attributable to the reinsurance agreement with Liberty Corporate Capital (Two) Ltd. (“LCC2”), contributing total \$5,229 to the overall decrease in general and administrative expenses. The remaining decrease is attributable to various cost effective measures taken by the Company in effort to reduce its operating costs.

2. GOVERNANCE STRUCTURE

2.1 Board and senior executive structure, role, responsibility 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 its responsible for the maintenance of an effective corporate governance framework. As of December 31, 2021 the Board consisted of the following four executive directors:

Name	Board Position
Steven Horton	Director
Joseph Hobbs	Director
Snjezana Tremblay	Director
Chen Foley	Director
Rachel Derry	Director

The Board delegates oversight of certain key areas to its Audit, Investment and Underwriting and Risk committees.

Audit and Risk Management Committee

The Audit and Risk Management Committee oversees the Company’s risk management exposures and makes recommendations to the Board regarding management’s proposals for the risk management framework, Risk Appetite, Key Risk Limits and the use of the Company’s Commercial Insurer Solvency Self-Assessment (CISSA).

The Audit and Risk Management Committee is also responsible for assisting the Board in its oversight of the integrity of the financial statements, regulatory reporting and for reviewing effectiveness of the Company’s internal accounting and financial controls. The Audit and Risk Management Committee also responsible for oversight and review of both internal and external audit functions.

Investment Committee

The Investment Committee is primarily responsible for overseeing and development of the investment strategy and all significant investing activities. The Investment Committee also monitors compliance of investment portfolios with the policies, guidelines and risk limits.

ii. 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, 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.

Name	Position
Steven Horton	President of Liberty Specialty Markets Bermuda
Nicholas Garside	Chief Underwriting Officer
Alice Blake	Senior Underwriter - Financial Risk Reinsurance
Joseph Hobbs	Senior Vice President and General Counsel of the specialty lines divisions of LMIC
Steven Beadle	Chief Financial Officer
Snjezana Tremblay	Chief Risk and Compliance Officer
Chen Foley	Head of Claims
Mark D’Amato	Assistant Vice President and Assistant Treasurer for the Liberty Mutual Group

2.2 Remuneration policy

i. Director compensation

The directors are not separately compensated for their Board roles.

ii. Executive compensation

The Company's executive compensation program currently consists of three principal elements: base salaries, annual bonus and long-term incentive compensation. Base salary provides the fixed portion of an executive's compensation and is established largely based on scope of responsibilities and individual and Company performance in the preceding year. Annual bonus and long-term incentive compensation each represent variable compensation and designed to reward performance consistent with financial and individual operational performance objectives.

iii. Employee compensation

All LSM Bermuda employees receive a fixed based salary (commensurate with their role, experience, annual performance in the prior year and prevailing market conditions) and annual performance-based bonus. In addition, employees benefit from various benefit plans, including medical and dental insurance, long-term disability insurance and life insurance.

iv. Supplementary/Early retirement schemes

All employees based in Bermuda receive an amount equal to 10% of their base salaries in respect of a retirement benefit contribution.

2.3 Fitness and proper requirements

i. Description of the Fit and Proper Process in Assessing the Board and Senior Executive

LSM Bermuda ensures that all key functions are fit to provide sound and prudent management through their professional qualifications, knowledge and experience. The Company is guided by various criteria when assessing fitness and propriety of key functions. The most important factors considered by LSM Bermuda include honesty, integrity and reputation, competence and capability and financial soundness.

In order to ensure that board and senior executives are fit, they are recruited giving due regard to the interview requirements, referencing, required skillset, professional and personal background, and other checks as required and relevant to the role to be undertaken. Examples of general checks include educational background check and professional qualifications check. In order to ensure that board and senior executives are proper they are subject to a variety of checks at the commencement of their assessments. Examples include identity checks, social media, criminal record and other relevant checks. If the Company is notified or becomes aware of, any circumstances under which any board or senior executive ceases to meet fit and proper criteria, we will perform a further review if necessary. This review may result in a temporary or full suspension of them being able to continue to carry out their function.

ii. Board and Senior Executives qualifications

Steven Horton - President - Liberty Specialty Markets Bermuda

Mr. Horton is responsible for the Liberty Specialty Markets (LSM) Bermuda platform, setting and executing strategy in line with the Company's global LSM vision.

Mr. Horton joined the Ironshore International in 2008, through the Company's Lloyd's platform, Pembroke Managing Agency Limited. Mr. Horton worked as a primary financial institutions underwriter before transferring to Liberty Specialty Markets Agency (LSMA), formerly known as "Iron-Starr Excess Agency", in 2010. At the Agency, he was initially charged with growing our international business, before being promoted to the financial lines manager and subsequently to Chief Executive Officer of the Agency. Mr. Horton moved into his role as President in late 2018 and oversees the Bermuda platform. Mr. Horton holds a B.A. (Hons) from The University of Westminster and is a Harvard Business School alum.

Nicholas Garside – Chief Underwriting Officer – Liberty Specialty Markets Bermuda

Mr. Garside joined the Company in January 2018 as Senior Vice President of Property. Mr. Garside's more than 15-year career in the insurance industry includes time spent in the United States, Bermuda, England, and Australia, in both broking and underwriting roles. Mr. Garside joined the Company from Novae Bermuda where he was Deputy Head of Direct & Facultative Property. During his time at Novae, he was jointly responsible for building out the Lloyd's syndicates US open market property book, achieving profitable scale in less than 2 years. Prior to this Mr. Garside spent 6 years with Allied World in Boston where he managed a diversified portfolio of property risks that varied in size from multinational to single location exposures across all industry segments. Prior to underwriting, Nick worked as a property broker for Willis splitting his 7 years between their London, Sydney & Bermuda offices. Mr. Garside has an Advanced Diploma in Insurance (ACII) and a BA (Hons) degree in Financial Services.

Alice Blake -Head of Reinsurance - Liberty Specialty Markets Bermuda

Ms. Blake is responsible for the Liberty Mutual Reinsurance (LM Re) portfolio on the Bermuda platform. Ms. Blake joined the LSM Bermuda in April 2019, having transferred from the LSM London office. Ms. Blake joined LSM in London in 2014 as a reinsurance underwriter in Political Risk and Trade Credit classes of business and has over twelve years of experience in the industry. Prior to LSM, Ms. Blake held underwriting roles in Political Risks and Trade Credit insurance at XL Insurance Company and Marketform Syndicate in London. Before joining the insurance industry, Ms. Blake worked at BAE systems in the UK, with placements in Australia and Spain. Ms. Blake holds an Advanced Diploma in Insurance (ACII) and a BA(Hons) degree in International Business Studies with Spanish.

Joseph M. Hobbs - Senior Vice President and General Counsel of the specialty lines divisions - Liberty Mutual Insurance Company

As Senior Vice President and General Counsel, Mr. Hobbs is responsible for providing strategic legal advice to senior management on all business strategies and operations within the specialty lines division including Liberty Specialty Markets Bermuda, Global Specialty, Liberty Mutual Surety, and Liberty Specialty Markets-London. Mr. Hobbs holds a B.S. in Accounting from Seton Hall University and a J.D. from Seton Hall University Law School.

Steven Beadle - Chief Financial Officer – Liberty Specialty Markets Bermuda

Mr. Beadle has more than 20 years' experience in accounting and finance with more than 16 years in the Bermuda insurance industry. Mr. Beadle joined LSM Bermuda in 2008 where he has served as the Financial Controller – Bermuda and the Corporate Controller for the group. Prior to joining the Company, Mr. Beadle spent two years with HSBC Insurance responsible for the financial and regulatory reporting of a portfolio of insurance companies. Prior to his move to Bermuda, Mr. Beadle worked in audit and finance roles in London, United Kingdom. Mr. Beadle is a Fellow Member of the Association of the Chartered Certified Accountants, holds a B. A. (Hons) in Economics with Further Mathematical Analysis from the University of Portsmouth, United Kingdom, and holds the Associate in Reinsurance (ARE) and Chartered Property Casualty Underwriter (CPCU) designations through the American Institute for Chartered Property and Casualty Underwriters (AICPCU).

Snjezana Tremblay- Chief Risk & Compliance Officer – Liberty Specialty Markets Bermuda

Ms. Tremblay is responsible for the oversight of all risk management and compliance practices for the LSM West region (Bermuda, LatAm & US). Ms. Tremblay joined the Company as Group Risk Manager in May 2014 and then held the role of Transformation Strategy & Risk Manager Liberty Mutual Global Risk Solutions in October 2018 prior to her current position. Ms. Tremblay has over ten years of experience in the industry, with previous roles at Deloitte in both Bermuda and Croatia and holds a B.B.A. in Finance from The University of Zagreb and an MSc in Risk Management from New York University – Leonard N. Stern School of Business. She is also a qualified Risk Manager through PRMIA and a qualified accountant.

Chen Foley - Head of Claims – Liberty Specialty Markets

Mr. Foley joined the Company in May 2016 as Vice President – Claims and Coverage. Mr. Foley is an experienced attorney qualified in both Bermuda and England. Prior to joining the Company Mr. Foley worked in private practice with an international law firm in Bermuda, advising (re)insurers and commercial clients in areas of international transactions, international regulations, insurance coverage and dispute resolution. He also practiced as a lawyer in London, England for a period of time where he advised

(re)insurers with respect to E&O and D&O coverage and represented clients in connection with litigation and arbitrations in London, Brussels, Denmark, Jersey, and Zurich.

In his current role as Head of Claims Bermuda, Mr. Foley maintains oversight of claims handling and resolution on behalf of the Property, General Liability, Healthcare, Financial Lines and Transactional Liability profit centers and leads a dynamic and high performing team of technicians and professionals. In addition to his claims related responsibilities Mr. Foley also supports the Bermuda platform by providing ad hoc legal counsel as required across an array of subject areas.

Mr. Foley holds a BA in Political Studies from Queen's University (Kingston, Canada), and read law at Queen Mary College (London, England). He completed the Bar Vocational Course at BPP Law School, London.

Mark D'Amato - Assistant Vice President and Assistant Treasurer - Liberty Mutual Group

In his role as Assistant Treasurer, Mr. D'Amato is responsible for the management of overall Group liquidity ensuring that cash is efficiently managed to maximum investment returns while ensuring all payment obligations are met. In addition, Mr. D'Amato is responsible for effectively managing debt and capital throughout the Group.

Mr. D'Amato has been employed by Liberty Mutual since 1992. Prior to his role as Assistant Treasurer, he served in a variety of roles within the Internal Audit Department as well as financial roles within Personal Lines Insurance and Dover Corporate Treasury. Mr. D'Amato holds a B.S. in Accounting from Bentley University and an M.B.A. from Northeastern University.

Rachel Derry - Executive Vice President and Senior Compliance Officer - Liberty Mutual Management (Bermuda) Ltd.

Ms. Derry is responsible for the client service platform and the overall operations of Liberty Mutual Management (Bermuda) Ltd. She joined the Liberty team in 2005 as an Account Manager and now holds the position of Executive Vice President. Ms. Derry oversees her team of qualified accountants who are responsible for managing commercial and captive insurance companies, segregated accounts companies, management companies and investment companies in Bermuda and Vermont. Liberty Mutual Management (Bermuda) Ltd. provides accounting, administration and corporate governance functions for its clients. Ms. Derry is on the executive committee of the Bermuda Insurance Manager's Association and participates in the Bermuda International Long Term Insurers and Reinsurers association.

Prior to working in insurance, Ms. Derry's background was ten years in accountancy practice in the UK. Ms. Derry gained the Certified Accounting Technicians (CAT) designation in 1999 and became a member of the Association of Chartered Certified Accountants (ACCA) in 2001. She was awarded a fellowship in 2006 (FCCA). Since moving to Bermuda and starting work with Liberty, she has obtained an Associate in Risk Management (ARM) designation, Associate in Reinsurance (ARe) designation, and Chartered Property Casualty Underwriter (CPCU) designation through the American Institute for Chartered Property and Casualty Underwriters (AICPCU).

2.4 Risk management and solvency self-assessment

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

Risk Governance

LSM Bermuda views risk management as the responsibility of every employee within the Company. Management believes that all aspects of the Company's business incorporate daily risk decisions. Communicating and outlining the Company's risk appetites and tolerances aids employees in making sound RM decisions. Senior management is responsible for setting the risk appetites and tolerances and communicating this information.

The Company's Enterprise Risk Management ("ERM") Framework is designed to help the Company engage with risk in a controlled fashion, consistent with available capital and the Board's Risk Appetite, helping generate appropriate returns to meet strategic objectives. It sets out our approach to how we define risk, cascade the risk appetites, the processes for ensuring the appropriate and timely identification, reporting, monitoring and management of risk and capital.

The ERM Framework is based on the industry leading practice "three lines of defence" model. Under this model, management, functional leaders, and risk owners ("first line" of defence) have responsibility for the day to day ERM framework. RM, compliance, and policies represent the "second line" of defence. The Audit Committee, Internal and External Audit that provide independent assurance represent the "third line" of defence. Senior Management has ownership and oversight roles to ensure that RM practices are made a priority and help ensure stated tolerances and appetites are adhered to.

LSM Bermuda also has its own Board of Directors, including an Audit Committee and Risk Management Committee ("ARMC") and Investment Committee ("IC"). The ARMC, in particular, is responsible for discussing and reviewing the effectiveness of the Company's ERM framework. The CRO facilitates and co-ordinates RM activity for LSM Bermuda and reports to the ARMC accordingly. The CRO is also a member of the LSM Bermuda Board.

Risk Appetite and Tolerances

Risk Appetite is expressed as a target range of each risk category within the Risk Universe set by the Board to assist LSM Bermuda in meeting its strategic objectives. The Board Risk Appetite statements are reviewed at least annually and may be revised at any point in the year in response to an actual or projected change in strategy or business planning, subject to Board approval.

Risk Reporting

Risk Management leverages the output of the monitoring processes performed by the first line to provide periodic updates to the Audit and Risk Management Committee and the Board. The CRO is responsible for reporting the actual risk position against the Board risk appetite to the Audit and Risk Management Committee and Board via the CRO Report, which also identifies any breaches, their cause, impact and means of rectification.

ii. Risk management and solvency self-assessment implementation

RM is implemented and integrated into the operations through risk management processes, procedures and risk mitigating controls. Risk mitigating controls are reviewed by RM to ensure their effectiveness and provide recommendations for any actions as necessary. RM is responsible for completing the Commercial Insurer's Solvency Self-Assessment ("CISSA"). The main purpose is to ensure that LSM Bermuda assesses all the risks inherent to its business and determine the corresponding capital needs.

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

The solvency self-assessment outlines the quality and quantity of capital needed to support LSM Bermuda's business goals. The solvency self-assessment seeks to identify and measure all material risks. Our ERM Framework outlines the level of Board approved risk appetite and tolerances for each category of risk, ensures risks are managed within its defined risk appetite and tolerances and ensure that an appropriate balance between risk and reward is achieved. LSM Bermuda seeks to provide an optimal return (maximizing returns within the given risk appetite) while preserving its capital at a level that is consistent with its business plan and risk appetite. The appropriate level of capital is determined by multiple factors including regulatory capital requirements, the business environment, conditions in the financial markets and assessments of potential future losses due to adverse changes in our business and market environments.

iv. Solvency self-assessment approval process

The solvency self-assessment reports are prepared by the RM team in consultation with the relevant functions and business units. After review by the CRO, the assessment report is provided to the Board for the approval emphasising significant changes during the year, and any current or emerging risk exposures.

2.5 Internal controls

i. Internal control system

LSM Bermuda has systems, processes and procedures to ensure accurate, timely and secure reporting, and adherence with applicable laws and regulations.

LSM Bermuda utilizes the internal control model that comprises three lines of defense. The three lines of defense addresses how specific duties related to risk and control are assigned and managed within the organization. The three separate lines of defense are organized in the framework developed by the Institute of Internal Auditors (“IIA”) and each line performs the following activities:

Functions that own and manage risk and control (front line operating management):

The majority of employees comprise the first line of defense. Senior management has responsibility setting the organization’s objectives, defining strategies to achieve those objectives, and establishing governance structures. Operational management identifies, assesses, controls, and mitigates risks, guiding the development and implementation of internal policies and procedures and ensuring that activities are consistent with goals and objectives. Managers design and implement detailed policies and procedures that serve as controls and supervise execution of those procedures by their employees.

Functions that monitor risk and control in support of management (RM and Compliance functions):

RM assists risk owners in defining the target risk exposure and reporting adequate risk-related information throughout the organization. Beyond this, RM work with control owners to facilitate the attestation process and ensure that controls are designed and operating effectively. Partially ineffective or ineffective controls are challenged by the RM function and must be actioned by control owners. The Compliance Function monitors various specific risks such as noncompliance with applicable laws and regulations.

The function that provides independent assurance to the Board and senior management concerning the effectiveness of management of risk and control (Internal Audit):

Internal Audit provides senior management and the Audit and Risk Management Committee with assurance based on independence and objectivity. Internal Audit provides assurance on the effectiveness of governance, risk management, and internal controls, including the manner in which the first and second lines of defense achieve risk management and control objectives. The Internal Controls team within the Internal Audit function provides independent testing of management’s controls.

ii. Compliance function

LSM Bermuda is committed to complying with all laws that govern our business and expect every employee to follow the law in their day-to-day business dealings. To ensure compliance with applicable laws and regulations, Compliance department assists with setting various policies, procedures and guidelines. The Compliance department also provides trainings to help employees stay abreast of increasing laws and regulations. The Liberty Global Compliance and Ethics (“GC&E”) team monitors the adherence to the Company’s Code of Business Conduct and Ethics. All material violations are reported to the Board and rectified accordingly. A Whistleblower Hotline is available which may be contacted on an anonymous nature. Calls to the hotline are reported through the GC&E chain and the board as required.

iii. Internal audit function and its independence and objectivity when conducting its functions

The mission of the Internal Audit function is to provide independent and objective assurance and consulting services designed to add value to support the Company’s strategic objective and improve its operations. The purpose is to enhance and protect organizational value by providing risk-based and objective assurance, advice and insight. Internal Audit assists the Company in accomplishing its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of governance, risk management, and control processes.

Consistent with the organization's needs, the Company develops and executes a flexible, risk-based audit plan to determine the priorities of the Internal Audit activity. Risks considered when building the audit plan include financial, operational, compliance, strategic and reputational risks. Internal Audit is also responsible for auditing information systems and the controls embedded within those systems to support organizational processes and goals. Audits are designed to ensure that LSM Bermuda is functioning in the most efficient manner, and that controls are adequate. Audit activities are complemented by periodic follow-up procedures for confirmation of remedial actions.

Through the execution of this plan, the department is able to determine whether the governance processes are adequate and functioning in a manner to ensure the following: significant financial, managerial, and operating information is accurate, reliable and timely; employees' actions are in compliance with policies, standards, procedures, and applicable 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 process; and, significant legislative and regulatory issues impacting the Company are recognized and addressed appropriately.

The purpose, scope, authority and responsibilities of the Internal Audit function are set out within the Internal Audit Charter, which is reviewed and updated on an annual basis, or more frequently, if required, and approved by the Audit and Risk Committee. Internal Audit's independence and objectivity depends largely on having no operational responsibility for or authority over any of the activities subject to review. While Internal Audit may take an active role in the formulation of policy or development of new systems (process or technical), it will be an advisory capacity only, with final decisions and implementation being the responsibility of appropriate management.

iv. Actuarial function

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 include:

- Estimating the gross and net technical provisions, including 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;
- 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;
- Building and maintaining rating models and the process of rate monitoring;
- Providing an opinion on the underwriting policy, providing opinion on the reinsurance arrangements, and contributing to the effective implementation of the risk management system.

2.6 Outsourcing

i. Outsourcing policy and key or important functions that have been outsourced

LSM Bermuda has an outsourcing policy, and the Board holds broad responsibility for review and approval of critical business functions of the Company. The terms and conditions of the outsourcing contract are approved by the Board. The outsourcing policy also outlines the process of selection of the service providers, and the procedures to be taken to monitor the work of outsourced partners and ensure that arrangements do not negatively affect the Company's reputation. Designated individuals manage services provided by outsourced vendors.

The Board is responsible for ensuring that an outsourcing arrangement does not diminish the Company's ability to fulfil its obligations to customers or its regulator, nor impede effective supervision by its regulator. Fundamental responsibilities such as the setting of strategies and policies, the oversight of the operation of the processes, and the final responsibility for customers, are not outsourced.

ii. Description of material intra-group outsourcing

Some functions are outsourced within the group including Actuarial, Financial Planning and Analysis, IT Security and some aspects of Risk Management, with oversight from the LSM Bermuda Board.

The information technology platform has been centralized for efficiency and economies of scale. The Company is dependent upon a third party, Genpact, for certain administrative and operational services. Genpact and EXL provide us with global administrative and operational services, including limited information technology services, back office services related to insurance operations and accounting functions, database management and reporting services.

Investment management has been outsourced to Liberty Mutual Investment (“LMI”) and managed in accordance with the Liberty Mutual Group investment policy guidelines. The investment management is subject to a rigorous oversight process implemented at Liberty Mutual Group, with reporting to the Company’s Investment Committee.

3. RISK PROFILE

3.1 Material risks insurer is exposed to during the reporting period

LSM Bermuda has identified various risk categories to which the Company is exposed. The Risk Register contains a listing of the main risks in relation to insurance, liquidity, market, credit, operational, strategic and group as aspects of the business.

Insurance Risk is defined as the risk of a change in value caused by ultimate costs for full contractual obligations varying from those assumed when the obligations were estimated. Insurance risk is split for the legal entity into Underwriting Risk and Reserve Risk.

Liquidity Risk is defined as the probability of loss arising from situations where LSMBL either has insufficient cash or liquid funds to meet its financial obligations as they fall due, or is required to sell assets below their fair value to meet cash demands

Market Risk is the risk of fluctuations to the net asset value (NAV) due to the volatility or level of financial variables impacting primarily the value of fixed income and equity securities, and private equity funds and the discounted value of net-liabilities. Market risk includes interest rate risk, spread risk, private equity risk, and FX rate risk.

Credit Risk is defined as the risk of a financial change in value due to actual credit losses deviating from expected credit losses due to the failure of another party to meet its contractual debt obligations to LSM and is split into Reinsurance and Other risks.

Operational Risk is defined as the risk of loss to LSMBL resulting from inadequate or failed internal processes, people and systems, or from external events.

Strategic Risk is defined as the risk of loss to LSMBL arising from key business and strategic decisions, improper implementation of decisions or lack of responsiveness to industry changes.

Group Risk is defined as the risk of loss to LSMBL arising from its membership of LSM, GRS, and the Liberty Mutual Group.

3.2 Risk mitigation

RM is primarily represented at the ARMC Meetings. This ensures adequate flow of risk information and provides an opportunity to discuss with key staff the existing risk areas, identification of potential emerging risks and risk mitigation techniques. RM meets with Risk Owners regularly to review their risks, assess whether any changes to either the inherent or residual risk measurements are required, discuss the current mitigating controls for their risk, discuss emerging risks and consider whether any future management actions have been identified.

The main changes to risk controls are agreed with risk control owners and documented in our new Strategic risk system – Decision Focus. RM regularly reviews the Risk Register in respect of the appropriateness of the measure of risk at both inherent and residual levels.

The risk and control owners have responsibility for monitoring their respective risks but are assisted and challenged by RM and Internal Audit. Risk owners have the responsibility of escalating or communicating any issues they find with the mitigating controls that are in place for these risks. The ongoing and formal risk assessment process ensures that the risk profile of LSM Bermuda is monitored against the stated risk appetite and risk tolerance levels.

3.3 Material risk concentrations

LSM Bermuda maintains and monitors tolerances around key risk exposures. Exposures are monitored by the ERM function.

In addition, our investments are subject to several risk limits and formal tolerances. The Company has policies governing risk concentrations in relation to counterparties, credit quality, sectors and geographical locations.

3.4 Investment in assets in accordance with the prudent person principles of the Code of Conduct

LSM Bermuda's investment portfolio is managed by Liberty Mutual Investment ("LMI") in accordance with the Liberty Mutual Group investment policy guidelines. In order to achieve the investment objectives, the portfolio is diversified and is managed with consideration for risks such as market risk, credit risk, interest rate risk, currency risk and liquidity risk. The guidelines ensure that highly liquid and low volatility fixed income securities support the technical provisions to ensure that claims can be paid on a timely basis. The size of the high quality investment portfolio is determined by the amount of technical provisions recorded for the quarter plus a large safety buffer. These guidelines are reviewed on an annual or ad hoc basis if any significant deviations have occurred that affect the financial markets.

3.5 Stress testing and sensitivity analysis to assess material risks

Various stress tests are performed to determine the adequacy of capital/liquidity to ensure regulatory requirements are met. The tests performed relate to underwriting risk exposures. The remaining traditional risk categories (e.g., interest rate risk and market risk) are also estimated.

4. SOLVENCY VALUATION

4.1 Valuation bases, assumptions and methods to derive the value of each asset class

The consolidated financial statements for LSM Bermuda are prepared in conformity with accounting principles generally accepted in the United States of America ("U.S. GAAP"). These consolidated financial statements form the basis for the preparation of both the Economic Balance Sheet ("EBS") and the Statutory Financial Statements ("SFS") as required under Bermuda insurance regulations. The EBS and SFS are used by both LSM Bermuda and the Bermuda Monetary Authority in assessing the minimum solvency and capital requirements. With certain exceptions, assets and liabilities are assessed and included on the EBS at fair value.

The following paragraphs detail how the asset classes are valued in accordance with U.S. GAAP and documents any differences between the valuation base in the Company's consolidated financial statements under U.S. GAAP and the EBS.

Cash and short term investments

Cash and cash equivalents have an original maturity of ninety days or less. Short term investments, which are managed as part of the Company's investment portfolio, have a maturity of one year or less when purchased and are carried at cost which approximates fair value.

Fixed maturity securities

Fixed maturity securities are valued in accordance with mark to market principles where possible. Quoted market prices in active markets for similar assets with adjustments to reflect differences are considered if mark to market valuation is not possible. Fixed income securities that are not actively traded and for which similar assets are also not actively traded pricing services are used to prepare inputs to assist with mark to model valuations.

Other investments

The fair value of other investments is estimated using the net asset value ("NAV") as provided by the general partners or investment managers. As the NAV obtained from the general partners or investment managers lags by one quarter as of the measurement date, the Company considers any adjustment to the most recent NAV such as capital calls, distributions, redemptions and all other information available to the Company.

Premiums receivable

Premiums receivable represent amounts currently due and amounts not yet due on insurance and reinsurance policies. The Company monitors the credit risk associated with premiums receivable, taking into consideration the impact of the Company's contractual right to offset loss obligations or unearned premiums against premiums receivable. Amounts deemed uncollectible are charged to net earnings in the period they are determined.

Under the EBS approach premiums receivable are valued in line with U.S. GAAP with the exception that any balance due in more than one year is discounted. In addition, premium receivable that is not contractually due or is deferred as at the balance sheet date is included within the technical provisions.

Deferred tax assets

When the Company's assessment indicates that it is more likely than not that all or some portion of deferred income tax assets will not be realized, a valuation allowance is recorded against the deferred tax assets. For the years ended December 31, 2021 and 2020, management determined no valuation allowance as necessary. The valuation methodology for deferred tax assets under U.S. GAAP is consistent with the valuation approach for EBS purposes.

Reinsurance recoverable on losses

Amounts billed to, and due from, reinsurers resulting from paid movements in the underlying business are calculated in accordance with the terms of the individual reinsurance contracts. Similarly, reinsurance balances recoverable related to the case reserves are calculated by applying the terms of any applicable reinsurance coverage to movements in the underlying case reserves. The estimate of reinsurance balances recoverable related to incurred but not reported ("IBNR") reserves is recognized on a basis consistent with the underlying IBNR reserves. The reinsurance balances recoverable are presented net of a provision for uncollectible amounts, reflecting the amount deemed not collectible due to credit quality, collection problems due to the location of the reinsurer, contractual disputes with reinsurers over individual contentious claims, contract language or coverage issues.

Deferred acquisition cost

Under U.S. GAAP acquisition costs, consisting principally of commissions and brokerage expenses and certain premium taxes and fees incurred at the time a contract or policy is issued and that vary with and are directly related to the successful efforts of acquiring new insurance contracts or renewing existing insurance contracts, are deferred and amortized over the period in which the related premiums are earned.

Under the EBS approach deferred acquisitions costs are valued at nil in order to avoid double counting as deferred acquisitions costs are implicitly included in the premium provision valuation within the technical provision.

Prepaid reinsurance premiums

Unearned premiums represent the portion of premiums written that relate to the unexpired terms of policies in force. Premiums ceded are similarly pro-rated over the period the coverage is provided with the unearned portion being deferred as prepaid reinsurance premiums.

Under the EBS approach prepaid reinsurance premiums are valued in line with U.S. GAAP with the exception that any balance due in more than one year is discounted. In addition, premium receivable that is not contractually due or is deferred as at the balance sheet date is included within the technical provisions.

Other assets

The valuation methodology for other assets under U.S. GAAP is consistent with the valuation approach for EBS purposes.

4.2 Valuation bases, assumptions and methods to derive the value of technical provisions

Insurance technical provisions are valued based on best-estimate cash flows, adjusted to reflect the time value of money using a risk-free discount rate term structure. In addition, there is a risk margin to reflect the uncertainty inherent in the underlying cash flows, which is calculated using risk-free discount rate term structure as prescribed by Bermuda Monetary Authority ("BMA").

The best-estimate for loss and loss expense provisions is calculated by using U.S. GAAP reserves as a starting point. The U.S. GAAP reserves for losses and loss adjustment expenses represent the Company's best estimate of loss and loss expenses reserves on an undiscounted basis. The discounted reserve is then calculated using expected payout patterns and the risk-free yield curves published by BMA.

The best-estimate for premium provisions is calculated using the unearned premium reserve on U.S. GAAP basis, adjusting for bound but not incepted business as of December 31, 2021, and applying expected loss and expense ratios and appropriate claims payout patterns to derive cash flows, which are then discounted using a risk-free discount rate term structure as prescribed by BMA.

The risk margin is calculated using a cost of capital approach and discounted using a risk-free discount rate term structure as prescribed by BMA, using the risk-free discount curve propagated by BMA.

As of December 31, 2021, the total technical provisions were comprised of the following:

	<u>Net provision</u>
Best estimate loss and loss expense provision	\$671,186
Best estimate premium provision	(73,731)
Risk margin	86,393
Total insurance technical provisions	<u>\$683,848</u>

4.3 Description of recoverable amounts from reinsurance contracts

In the normal course of business, LSM Bermuda seek to reduce the potential amount of loss arising from claims events by reinsuring certain levels of risk with other insurers and reinsurers. Amounts recoverable from reinsurers are estimated based on the terms and conditions of the reinsurance contracts, in a manner consistent with the underlying liabilities insured. The reinsurance balances recoverable are presented net of a provision for uncollectible amounts.

4.4 Valuation bases, assumptions and methods to derive the value of other liabilities

Insurance and Reinsurance Balances Payable

Insurance and reinsurance balances payable principally represents ceded premiums payable and profit commissions payable to third party reinsurance companies or program administrators.

Other liabilities

Other liabilities represent accounts payable and accrued expenses as well as other liabilities. The carrying value of other liabilities approximated their fair values of December 31, 2021, due to their respective short maturities.

5. CAPITAL MANAGEMENT

5.1 Eligible capital

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

As the profile and strategic plans change, so do capital needs. The Board recognizes the importance of having a plan for addressing capital requirements to meet its strategic plans for growth and in times of crisis. The capital management process seeks to provide a thorough and realistic structure for maintaining an efficient level of capital. Shortfalls are managed by setting out actions that may be undertaken based on the severity and urgency of the deficit.

In the short to medium term, capital management is closely aligned with the business planning process and utilizes the risk appetite to guide business decisions. In the long term, the strategy is to consistently deliver superior profitable growth through a balanced and diversified portfolio with a keen focus on execution. This is accomplished through revenue growth, expense management, investment management, focus on underwriting specialty lines and developing top talent.

There have been no material changes to capital and how it is managed during the reporting period.

- ii. Eligible capital categorized by tiers in accordance with the eligible capital rules

Eligible capital as of December 31, 2021 is categorized into the following tiers:

	<u>December 31, 2021</u>	<u>December 31, 2020</u>
Tier 1	\$1,633,717	\$1,845,044
Tier 2	66,509	75,042
Tier 3	-	-
Total	<u>\$1,700,226</u>	<u>\$1,920,086</u>

The majority of capital is Tier 1, which is comprised of fully paid common shares, contributed surplus and retained earnings. The Company has immaterial amount of Tier 2 capital, which is made up of the excess of assets encumbered for policyholder obligations and actual policyholder obligations.

- iii. Eligible capital categorized by tiers, in accordance with the eligible capital rules used to meet ECR and MSM requirements of the Insurance Act

Eligible capital for the Minimum Margin of Solvency (MSM) and Enhanced Capital Requirement (ECR) as of December 31, 2021 is categorized as follows:

	<u>Limits</u>	<u>MSM</u>	<u>ECR</u>	<u>Minimum margin of solvency</u>	<u>Enhanced capital requirement</u>
Tier 1	Min	80%	60.00%	\$1,633,717	\$1,633,717
Tier 2	Max	25%	66.67%	66,509	66,509
Tier 3	-	-	17.65%	-	-
Total				<u>\$1,700,226</u>	<u>\$1,700,226</u>

- iv. Confirmation of eligible capital that is subject to transitional arrangements

Not applicable

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

Not applicable

vi. Identification of ancillary capital instruments approved by the BMA

Not applicable

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

	<u>December 31, 2021</u>	<u>December 31, 2020</u>
Reconciliation of U.S. GAAP to BSCR (EBS) capital		
Shareholder's equity per U.S. GAAP	\$1,777,718	\$1,998,840
Remove non-admitted prepaid expenses	(85)	(189)
Remove non-admitted goodwill and intangible assets	-	-
Add liabilities for letters of credit, guarantees and other	(5,035)	(5,035)
Bermuda statutory capital and surplus	\$ 1,772,598	\$ 1,993,616
Gross loss and loss expense provision	14,024	11,161
Gross premium provision	388,679	405,350
Risk Margin	(86,393)	(84,692)
Deferred gain on retroactive contract	-	-
Premiums receivable not yet due	(388,682)	(405,349)
Statutory economic capital and surplus	\$ 1,700,226	\$ 1,920,086

5.2 Regulatory capital requirements

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

As of December 31, 2021, regulatory capital requirements under revised methodology were assessed as follows:

	<u>December 31, 2021</u>	<u>Ratio</u>
Bermuda Solvency Capital Requirement	\$864,185	197%
Enhanced Capital Requirement	\$910,345	187%

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

LSM Bermuda was compliant with the requirements of the MSM and the ECR 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.

5.3 Approved internal capital model

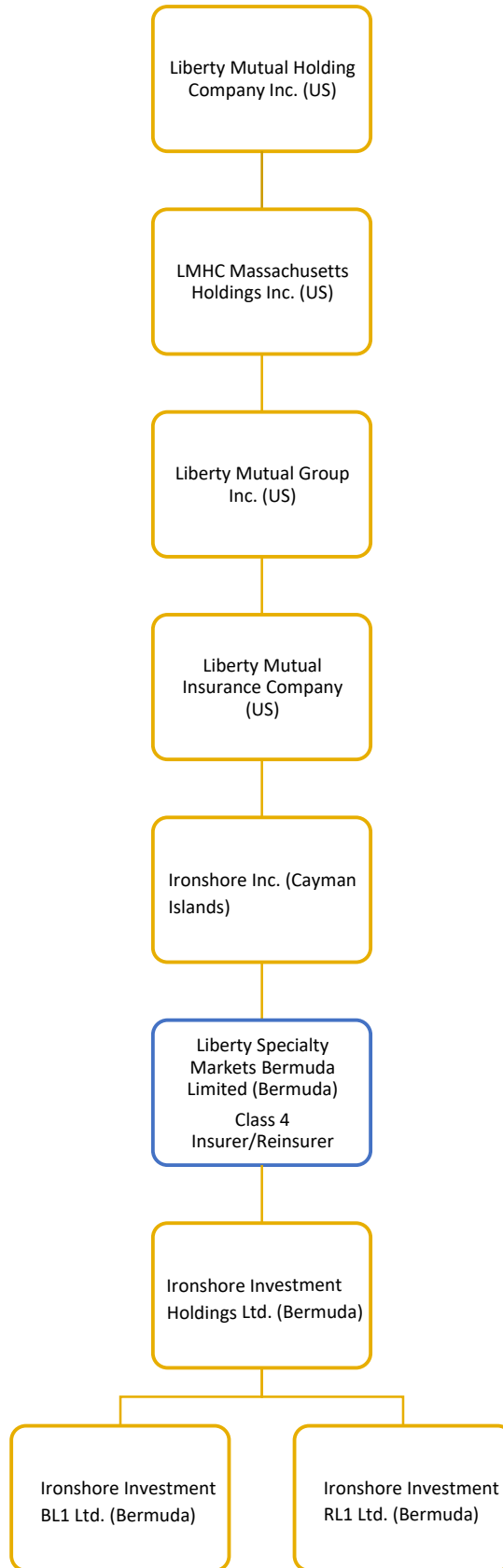
LSM Bermuda does not utilize an approved internal capital model to derive ECR. The ECR is based on the BSCR model.

6. SUBSEQUENT EVENTS

Subsequent to December 31, 2021, LCC2, a capital provider of Syndicate 2014, completed RITC transaction of the legacy liabilities of the 2019 and 2018 Years of Account of Syndicate 2014, managed by Hamilton Managing Agency. Under the agreement, legacy Syndicate 2014 business that remained with LCC2 will be transferred to Syndicate 3500 managed by RiverStone Managing Agency Limited effective January 1, 2022.

This transaction effectively commuted the existing reinsurance agreement between the Company and LCC2 for the 2019 and 2018 Years of Account of Syndicate 2014. A favorable development of approximately \$3,906 has been recorded in the Company's financial results subsequent to the year end.

Appendix A: LSM Bermuda Legal Organization Chart



All ownership of a direct subsidiary is 100%