# ASSURED GUARANTY (EUROPE) PLC

# SOLVENCY AND
# FINANCIAL CONDITION REPORT
# 2018

# CONTENTS

# GLOSSARY OF ABBREVIATIONS AND DEFINITIONS

| Term | Definition |
|---|---|
| AGC | Assured Guaranty Corp. |
| AGC Reinsurance Agreement | Reinsurance agreement between AGE and AGC dated 7 November 2018 |
| AGE | Assured Guaranty (Europe) plc |
| AGL | Assured Guaranty Ltd. |
| AGL Group | AGL and its subsidiaries |
| AGLN | Assured Guaranty (London) plc |
| AGM | Assured Guaranty Municipal Corp. |
| AGM Net Worth Maintenance Agreement | Net Worth Maintenance Agreement dated 7 November 2018 between AGM and AGE |
| AGM Reinsurance Agreement | Quota share and excess of loss reinsurance agreement between AGE and AGM dated 7 November 2018 |
| AGUK | Assured Guaranty (UK) plc |
| AG (UK) Services | Assured Guaranty (UK) Services Limited |
| AGUS Services | AG US Group Services Inc. |
| Approved Person | Someone who is approved to perform a SMF or CF |
| BIG | Below-investment-grade |
| Board | Board of Directors |
| Brexit | UK's expected departure from the EU |
| CEO | Chief Executive Officer |
| CF | Controlled Functions |
| CFO | Chief Financial Officer |
| CIFGE | CIFG Europe S.A. |
| Company | Assured Guaranty (Europe) plc |
| Directive | Directive 2009/138/EC of the European Parliament and of the Council on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II), as amended from time to time |
| ECM | Economic Capital Model |
| EEA | European Economic Area |
| EIOPA | European Insurance and Occupational Pensions Authority |
| EU | European Union |
| FCA | The Financial Conduct Authority |
| Fitch | Fitch Ratings Inc. |
| GBP | Great Britain Pound |
| GPO | Gross par outstanding |
| Group Service Agreement | Second Amended and Restated Service Agreement among AGE, AGUS Services and other affiliates, effective 1 January 2017, as the same may be amended or restated from time to time, including by the First Amendment thereto dated 12 January 2017 |
| ICA | Individual Capital Assessment |
| IG | Investment Grade |
| ISCC | International Supervisory Credit Committee |
| IT | Information Technology |
| KBRA | Kroll Bond Rating Agency Inc. |
| Key Function | The Key Functions specified in the Directive |
| KFH | The holders of Key Functions |
| KRIs | Key risk indicators |
| LTIP | Long term incentive plan |
| MCR | Minimum Capital Requirement |

| Term | Definition |
|---|---|
| Merger | The Company's merger with its subsidiaries effected under Part VII of the Financial Services and Market Act 2000 and French insurance portfolio transfer procedures, pursuant to the Companies (Cross-Border Merger) Regulations 2007 and French Commercial Code |
| Moody’s | Moody’s Investors Service Inc. |
| NPO | Net par outstanding |
| NYDFS | The New York Department of Financial Services |
| ORSA | Own Risk and Solvency Assessment |
| Par | Par value of the obligation |
| PF | Public finance |
| plc | Public limited company |
| PRA | The Prudential Regulation Authority |
| PRMC | Portfolio Risk Management Committee |
| PVP | Gross upfront and instalment premiums received plus the present value of gross estimated future instalment premiums, on contracts written in the current year, discounted at 6% per year. |
| Rating Agencies | S&P, KBRA, and Moody’s |
| RMBS | Residential Mortgage-Backed Securities |
| RMC | Risk Management Committee |
| ROC | Risk Oversight Committee |
| S&P | S&P Global Ratings, a division of Standard & Poor's Financial Services LLC |
| SCR | Solvency Capital Requirement. |
| SCR Ratio | Ratio of Eligible Own Funds to SCR |
| SEC | US Securities and Exchange Commission |
| SF | Structured finance |
| SFCR | Solvency and Financial Condition Report |
| SMF | A Senior Manager Function specified in the SMCR |
| SMCR | The UK’s Senior Managers and Certification Regime, which applies to the insurance and reinsurance sectors as of 10 December 2018 |
| Solvency II Regulation | Commission Delegated Regulation EU 2015/35 of 10 October 2014, as amended |
| SRL | Single Risk Limits |
| Standard Formula | Standard formula prescribed by EIOPA |
| UK | United Kingdom |
| UK Credit Committee | Credit Committee for AGE |
| UK GAAP | United Kingdom Generally Accepted Accounting Principles |
| US | United States of America |
| USD | US Dollars |
| USPs | Undertaking-specific parameters |

# INTRODUCTION

This Solvency and Financial Condition Report has been prepared in accordance with Solvency II and sets out information on the business and performance of the Company, its system of governance, risk profile, valuation of assets and liabilities for solvency purposes and capital management as at 31 December 2018.

Solvency II regulations and guidelines prescribe the structure of the document and the information required to be reported in each section. In preparing this report we have referenced each reporting requirement, separately commenting on its relevance to the Company.

In 2017 the Company prepared a single group SFCR for itself and its subsidiaries. In 2018 the Company combined its operations with those of its subsidiaries, AGUK, AGLN and CIFGE. To effect the Merger, AGUK, AGLN and CIFGE simultaneously:

(i) transferred their insurance portfolios to AGE in accordance with Part VII of the Financial Services and Markets Act 2000 and French insurance portfolio transfer procedures; and
(ii) merged with and into AGE pursuant to the Companies (Cross Border Mergers) Regulations 2007 and the French Commercial code.

AGUK, AGLN and CIFGE were dissolved on the date of the Merger without going into liquidation. The effective accounting date of the Merger was 1 November 2018, with the transferring assets and liabilities of the subsidiaries recognised by the Company from that date.

As a result of the Merger, for 2018 the Company presents a single solo SFCR which includes the operations of the former subsidiaries from 1 November 2018. Comparative information is presented for the Company on a solo basis. Further details of the Merger are provided within *Section A.* The impact of the Merger upon the Company's risk profile, valuation for solvency purposes and Own Funds is set out in Sections C, D and E respectively.

# SUMMARY

Assured Guaranty (Europe) plc is a public limited company incorporated in England and Wales. The principal activity of the Company is providing financial guarantees for public finance, infrastructure finance and structured finance obligations. Financial guarantee insurance written by the Company generally guarantees scheduled payments of principal and interest on an issuer's obligations in the event, and to the extent of, a payment default by the obligor. If an obligor defaults on a scheduled payment due on an obligation that is guaranteed by the Company, including scheduled interest or principal payments, the Company is required under its unconditional and irrevocable financial guarantee to pay the amount of the shortfall to the holder of the obligation.

The Company is authorised by the PRA and regulated by both the PRA and the FCA and is authorised to effect and carry out three classes of general insurance, specifically: classes 14 (credit), 15 (suretyship) and 16 (miscellaneous financial loss). In 2018 the Company underwrote financial guarantees on public and infrastructure finance obligations only. The Company also has permission to advise on, to arrange and to assist in the administration and performance of its financial guarantee insurance contracts.

The Company generally guarantees transactions under a co-guarantee structure with its parent company, AGM. AGM directly guarantees the remaining balance of the guaranteed obligations and also provides a second-to-pay guarantee for the Company's portion of the guaranteed obligations. For transactions closed prior to 2011, the Company typically guaranteed obligations directly and reinsured to AGM approximately 92% of the Company's retention, after cessions to other reinsurers. Transactions originally underwritten by AGUK and CIFGE and transferred to the Company under the Merger were reinsured 90% and 100% respectively to AGC. The Company entered into a new reinsurance agreement with AGC at the date of the Merger to preserve those reinsurance cessions.

AGE applies its credit underwriting judgement, risk management skills and capital markets experience to offer financial guarantee insurance for new transactions and to manage its existing portfolio of financial guarantees. AGE markets its financial guarantees directly to issuers and underwriters of public finance and structured finance securities as well as to investors in such obligations. After several years of low new business volume, AGE's financial guarantee product is currently showing itself to be competitive compared with other financing options in certain segments of the infrastructure market and the Company is now well positioned for growth within its key markets.

The obligations insured by the Company are generally awarded ratings on the basis of the financial strength ratings given to the Company by Rating Agencies. In December 2018 the Company obtained a rating for the first time from KBRA. As at 11 April 2019, the Company and AGM, its parent Company, have been assigned the insurance financial strength ratings set out below:

S&P: AA / Stable Outlook

Moody's: A2 / Stable Outlook

KBRA: AA+ / Stable Outlook

## BUSINESS AND PERFORMANCE

**Underwriting performance**

During the year the Company recorded a 93% increase in its key measure of new business, PVP, which increased to £11.6m (2017: £6.0m). The increase was principally the result of restructuring an existing transaction. The completion of the Merger during the year did not impact new business volumes as the operations of AGUK, AGLN and CIFGE had previously been placed into run-off.

The overall underwriting result for the year was a loss of £4.6m (2017: profit of £52.5m) due to the recognition of negative net earned premiums of £7.6m. Negative net earned premiums are the result of commutations with third party reinsurers for which gains achieved on termination of the reinsurance agreement are recognised immediately but the subsequent reinsurance cessions under the quota share cover of the AGM Reinsurance Agreement, made at the re-rated pricing of the risks, are earned over the life of reinsured policies.

The Company benefited from benign loss experience during the year with a reduction in unexpired risk provisions, net of reinsurance of £2.7m, partly offset by net claims incurred of £0.9m.

As a result of the Merger, the insured obligations of the Company increased significantly. As at 31 December 2018, the Company had issued guarantees on financial obligations with gross outstanding par of £23.6 billion (2017: £14.0 billion) and net par after reinsurance of £10.0 billion (2017: £0.5 billion). The significant increase in net par outstanding is principally due to the policies transferred to the Company from AGLN which have limited reinsurance.

The value of BIG obligations transferred to the Company as a result of the Merger had a gross par of £269.0 million and a net par after reinsurance of £196.3 million as at 31 December 2018. The Company's insured portfolio of guarantees split by obligation type as at 31 December 2018 is summarised below:

**Insured Portfolio by Sector**

| As at 31 December | 2018 | | 2017 | |
|---|---|---|---|---|
| | GPO | NPO | GPO | NPO |
| Sector | (in thousands) | | | |
| Infrastructure Finance | £ 10,233,689 | £ 4,283,192 | £ 6,146,799 | £ 193,948 |
| Regulated utilities | 9,891,029 | 4,228,106 | 6,064,928 | 222,241 |
| Other Public Finance | 3,025,243 | 1,346,743 | 1,580,336 | 42,867 |
| Insurance Securitisations | 66,724 | 6,672 | — | — |
| RMBS | 342,264 | 94,823 | 224,426 | 5,960 |
| Total | £ 23,558,949 | £ 9,959,536 | £ 14,016,489 | £ 465,016 |

**Investment performance**

The Company's investment portfolio consists primarily of high-quality, liquid, fixed income securities. Total investment return for the year was a loss of £0.1m (2017: gain of £1.2m). The low levels of return in both the current and prior year are due to net unrealised losses on government and corporate bonds as a result of widening credit spreads and the continued upwards trends in yields. The Company's preferred measure of its investment return is yield to maturity; as at 31 December 2018 the yield on the Company's investment portfolio was 2.05%.

## SYSTEM OF GOVERNANCE

The Company's Board has overall responsibility for directing and controlling the activities of the Company which includes the establishment and oversight of its system of governance. The Board and management of the Company are committed to high standards of corporate governance and have placed significant focus on the establishment and maintenance of a comprehensive and effective corporate governance framework. Integral to this framework are the structure of committees and functions established by the Board to oversee the day to day operations of the Company and to implement policies, procedures, guidelines and limits approved by the Board. Each of the committees and functions operates under terms of reference which are reviewed and approved by the Board, at least annually.

The risk management framework of the Company is organised around a three lines of defence model which ensures that all functions (both those that own risks, as well as the specialist risk management and compliance functions) are responsible for managing risks. These functions are supplemented by an independent (outsourced) Internal Audit Function which provides assurance over the operation of the risk management framework, including the Company's internal control framework.

There were no material changes in the Company's system of governance during the year. The systems of governance of AGUK, AGLN and CIFGE were generally consistent with those of the Company, and operated by persons also performing such roles for the Company. As such, the Merger did not materially impact on the Company's established governance.

Section B provides further details of the Company's committees, functions and risk management framework.

## RISK PROFILE

The most significant risk to which the Company is exposed remains underwriting risk, the key element of which, because of the nature of financial guarantee contracts written, is credit risk, i.e. the risk that obligors of insured obligations will fail to pay. The Company's exposure to credit risk (in terms of par value) has increased significantly during the year due to the Merger. The other material components of the Company's risk profile are market risk, counterparty risk, liquidity risk and operational risk.

The Company's tolerance for risk is established within its Risk Appetite Statement. The Company's risk exposures are controlled and monitored under the Company's internal control framework and risk management processes. The Company's ORSA ensures a continuous process of risk identification, measurement and monitoring.

Section C further describes the Company's material risk exposures, quantified measures of those risks and how the Company manages these risks.

## VALUATION FOR SOLVENCY PURPOSES

The Company's Solvency II balance sheet is prepared in accordance with the Solvency II Directive and related guidelines. Under Solvency II rules all assets and liabilities are required to be valued on a basis that reflects their fair value. The excess of the Company's assets over liabilities within its Solvency II balance sheet as at 31 December 2018 was £692.5m. Net assets as reported within the Company's UK GAAP financial statements were £771.0m. The adjustments made to the Company's UK GAAP balance sheet in moving to the Solvency II basis of valuation are set out below.

**Summary of adjustments to UK GAAP balance sheet**

| As at 31 December | | 2018 | | 2017 |
|---|---|---|---|---|
| | | (in thousands) | | |
| Net assets - UK GAAP | £ | 770,982 | £ | 553,836 |
| Disallowed items - Prepayments and Deferred Acquisition Costs | | 99,564 | | 103,735 |
| Investments in subsidiaries | | — | | 99,616 |
| Solvency II adjustment to net best estimate loss provision, risk margin & discounting | | (194,267) | | (112,215) |
| Deferred tax in Solvency II balance sheet | | 16,258 | | (15,746) |
| Excess of assets over liabilities - Solvency II | £ | 692,537 | £ | 629,226 |

Section D provides further details of the Company's Assets, Technical Provisions and Other liabilities under the Solvency II basis of valuation.

## CAPITAL MANAGEMENT

The primary objective of the Company's capital management policy is to ensure sufficient capital resources to meet both the Company's regulatory capital requirements as well as the Company's own economic capital assessment, the ICA.

The Company calculates its SCR using the Standard Formula. The ratios of the Company's Own Funds to its SCR and MCR are shown below.

**Summary of SCR and MCR**

| As at 31 December | | 2018 | | 2017 |
|---|---|---|---|---|
| | | (in thousands, except ratios) | | |
| Solvency II Own Funds | £ | 692,537 | £ | 629,226 |
| SCR | | 301,332 | | 112,617 |
| SCR Ratio | | 2.30:1 | | 5.59:1 |
| MCR | | 75,333 | | 28,154 |
| MCR Ratio | | 8.96:1 | | 22.35:1 |

The reduction in the SCR and MCR Ratios is due to the Merger which significantly increased the Company's capital requirement in respect of underwriting risk. The surplus of Own Funds over the SCR has decreased to £391.2 million from £516.6 million.

The Company's Own Funds structure, as defined under Solvency II rules, is principally comprised of Tier One Own Funds. The split of the Company's Own Funds by Solvency II Tiers is shown below.

**Summary of Own Funds by Tier**

| As at 31 December | | 2018 | | 2017 |
|---|---|---|---|---|
| | | (in thousands) | | |
| Tier 1 | £ | 675,161 | £ | 629,226 |
| Tier 2 | | — | | — |
| Tier 3 | | 17,376 | | — |
| Total | £ | 692,537 | £ | 629,226 |

*Section E* provides details of the Company's policies and procedures for the management of capital, as well as further details on the components of the Company's SCR.

## INDEPENDENT AUDITORS' REPORT

**Report of the external independent auditors to the Directors of Assured Guaranty (Europe) Plc ('the Company')**

**Report on the Audit of the relevant elements of the Solvency and Financial Condition Report**

**Opinion**

We have audited the following documents prepared by the Company as at 31 December 2018:

- The 'Valuation for solvency purposes' and 'Capital Management' sections of the Solvency and Financial Condition Report of the Company as at 31 December 2018, ('**the Narrative Disclosures subject to audit**'); and
- Company templates S.02.01.02, S.17.01.02, S.23.01.01, S.25.01.21 and S.28.01.01 ('**the Templates subject to audit'**).

The Narrative Disclosures subject to audit and the Templates subject to audit are collectively referred to as the '**relevant elements of the Solvency and Financial Condition Report'**.

We are not required to audit, nor have we audited, and as a consequence do not express an opinion on the **Other Information** which comprises:

- The 'Introduction', 'Summary', 'Business and performance', 'System of governance' and 'Risk profile' elements of the Solvency and Financial Condition Report;
- Company templates S.05.01.02, S.05.02.01 and S.19.01.21;
- The written acknowledgement by management of their responsibilities, including for the preparation of the Solvency and Financial Condition Report ('**the Responsibility Statement**').

In our opinion, the information subject to audit in the relevant elements of the Solvency and Financial Condition Report of the Company as at 31 December 2018 is prepared, in all material respects, in accordance with the financial reporting provisions of the PRA Rules and Solvency II regulations on which they are based.

**Basis for opinion**

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) including ISA (UK) 800 and ISA (UK) 805, and applicable law. Our responsibilities under those standards are further described in the *Auditors' Responsibilities for the Audit of the relevant elements of the Solvency and Financial Condition Report* section of our report. We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the Solvency and Financial Condition Report in the UK, including the FRC's Ethical Standard as applied to public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

**Conclusions relating to going concern**

ISAs (UK) require us to report to you where:

- the directors' use of the going concern basis of accounting in the preparation of the Solvency and Financial Condition Report is not appropriate; or
- the directors have not disclosed in the Solvency and Financial Condition Report any identified material uncertainties that may cast significant doubt about the Company's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the Solvency and Financial Condition Report is authorised for issue.

We have nothing to report in respect of the above matters.

However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the Company's ability to continue as a going concern. For example, the terms on which the United Kingdom may withdraw from the European Union, are not clear, and it is difficult to evaluate all of the potential implications on the Company's trade, customers, suppliers and the wider economy.

**Emphasis of Matter - Basis of Accounting**

We draw attention to the 'Valuation for solvency purposes' and 'Capital Management' sections of the Solvency and Financial Condition Report, which describe the basis of accounting. The Solvency and Financial Condition Report is prepared in compliance with the financial reporting provisions of the PRA Rules and Solvency II regulations, and therefore in accordance with a special purpose financial reporting framework. The Solvency and Financial Condition Report is required to be published, and intended users include but are not limited to the Prudential Regulation Authority. As a result, the Solvency and Financial Condition Report may not be suitable for another purpose. Our opinion is not modified in respect of this matter.

**Other Information**

The Directors are responsible for the Other Information.

Our opinion on the relevant elements of the Solvency and Financial Condition Report does not cover the Other Information and we do not express an audit opinion or any form of assurance conclusion thereon.

In connection with our audit of the Solvency and Financial Condition Report, our responsibility is to read the Other Information and, in doing so, consider whether the Other Information is materially inconsistent with the relevant elements of the Solvency and Financial Condition Report, or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the relevant elements of the Solvency and Financial Condition Report or a material misstatement of the Other Information. If, based on the work we have performed, we conclude that there is a material misstatement of this Other Information, we are required to report that fact. We have nothing to report in this regard.

**Responsibilities of Directors for the Solvency and Financial Condition Report**

The Directors are responsible for the preparation of the Solvency and Financial Condition Report in accordance with the financial reporting provisions of the PRA rules and Solvency II regulations.

The Directors are also responsible for such internal control as they determine is necessary to enable the preparation of a Solvency and Financial Condition Report that is free from material misstatement, whether due to fraud or error.

The Directors have elected to comply with the External Audit Part of the PRA Rulebook for Solvency II firms as if it applied to the Company, notwithstanding that the Company is a small firm for external audit purposes (as defined in the PRA Rulebook).

**Auditors' Responsibilities for the Audit of the relevant elements of the Solvency and Financial Condition Report**

It is our responsibility to form an independent opinion as to whether the information subject to audit in the relevant elements of the Solvency and Financial Condition Report is prepared, in all material respects, in accordance with financial reporting provisions of the PRA Rules and Solvency II regulations on which they are based.

Our objectives are to obtain reasonable assurance about whether the relevant elements of the Solvency and Financial Condition Report are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but it is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the decision making or the judgement of the users taken on the basis of the Solvency and Financial Condition Report.

A further description of our responsibilities for the audit is located on the Financial Reporting Council's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditors' report.

This report, including the opinion, has been prepared for the Board of Directors of the Company in accordance with our letter of engagement dated 10 April 2019 and External Audit rule 2.1 of the Solvency II firms Sector of the PRA Rulebook as if it applied to the Company, and for no other purpose. We do not, in providing this report, accept or assume responsibility for any other purpose or to any other party save where expressly agreed by our prior consent in writing.

**Report on Other Matters**

The Directors have requested that we consider whether the Other Information is materially inconsistent with our knowledge obtained in the audit of the Company's statutory financial statements as if the Company was subject to the External Audit Part of the PRA Rulebook for Solvency II firms. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

PricewaterhouseCoopers LLP

*PricewaterhouseCoopers LLP*

*Chartered Accountants*

London

12 April 2019

# A. BUSINESS AND PERFORMANCE

This section of the SFCR provides information about the Company's business, its structure and financial performance.

During the year, the Company successfully combined its operations with those of its subsidiaries, AGUK, AGLN and CIFGE. Under the Merger, the subsidiaries transferred their insurance portfolios and merged with and into the Company. The subsidiaries were dissolved on the date of the Merger without going into liquidation. The transaction was effected under Part VII of the Financial Services and Markets Act 2000 and French insurance portfolio transfer procedures, pursuant to the Companies (Cross Border Merger) Regulations 2007 and the French Commercial Code.

The effective accounting date for the Merger was 1 November 2018, with the transferring assets and liabilities of the subsidiaries recognised by the Company from that date. The financial performance of the Company includes the operations of the former subsidiaries from that date also. Further details of the Merger are provided in *Section A.1.g.*

The Company prepares its financial statements in accordance with UK GAAP. The financial performance information provided in this section is therefore presented on a UK GAAP basis, unless otherwise stated.

## A.1 BUSINESS

### a. Name and legal form

AGE is a public limited company registered in England and Wales (registration number 2510099). A simplified group structure is included in *Section A.1.e* below.

The registered office of the Company is:

11th Floor, 6 Bevis Marks
London
EC3A 7BA
United Kingdom

The Company is authorised by the PRA and regulated by both the PRA and the FCA.

### b. Name and contact details of the supervisory authority responsible for financial supervision

Prudential Regulation Authority
General Insurance Division
Bank of England
20 Moorgate
London
EC2R 6DA

### c. Name and contact details of the external auditor

PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
7 More London Riverside
London
SE1 2RT

### d. Holders of qualifying holdings in the Company

The Company is a wholly-owned subsidiary of AGM. AGM is an insurance company, which was organised under the laws of the State of New York, United States of America in 1984. AGM commenced operations in 1985 and has its principal place of business in New York. AGM provides financial guarantee insurance and reinsurance on debt obligations issued in the US and, together with AGE, in the international public finance (including infrastructure) markets. AGM is regulated by the NYDFS. The NYDFS has agreed to serve as the group regulator for the insurance companies in the AGL Group.

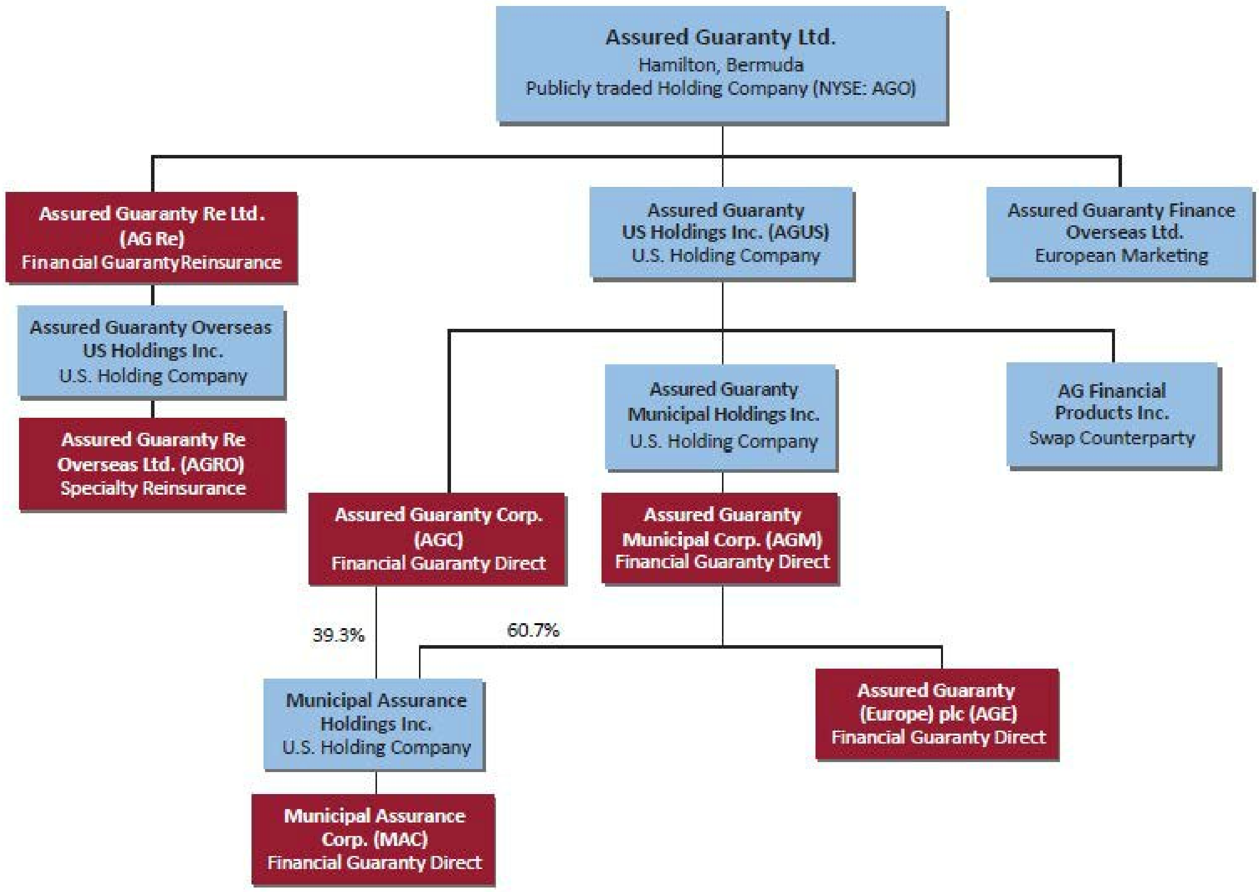
AGM is an indirect wholly-owned subsidiary of AGL. AGL (through a wholly owned holding company) acquired AGM (then named Financial Security Assurance Inc.), together with its holding company Financial Security Assurance Holdings Ltd. (renamed Assured Guaranty Municipal Holdings Inc.) and certain subsidiaries owned by that holding company on 1 July 2009.

AGL is a Bermuda-based holding company, which was formed in 2003, and as a public company, is subject to certain requirements of the SEC.

## e. Details of the undertaking's position within the legal structure of the AGL Group

The abbreviated organisational chart below shows the position of the Company as an indirect wholly owned subsidiary of AGL.

**Assured Guaranty Ltd. Corporate Structure**
(the ownership interest is 100% unless otherwise indicated below)




## f. Material lines of business and material geographical areas where business is underwritten

The principal activity of the Company is providing financial guarantees. AGE provides financial guarantees in the UK and certain countries within the EEA, specifically to the public finance (including infrastructure) and structured finance markets. In 2018, the Company provided financial guarantees on public and infrastructure finance obligations only. The Company's insured portfolio as at 31 December 2018 and 2017 by location of risk, split between Public and Structured finance is given in the table below. The gross and net par outstanding obligation of the insured portfolio have increased substantially during the year due to the Merger.

**Par insured by location of risk**

| As at 31 December | 2018 | | 2017 | |
|---|---|---|---|---|
| | Gross Par Outstanding | Net Par Outstanding | Gross Par Outstanding | Net Par Outstanding |
| **Country** | (in thousands) | | | |
| Public finance: | | | | |
| United Kingdom | £ 18,348,732 | £ 8,338,133 | £ 10,163,455 | £ 349,286 |
| France | 2,466,560 | 1,083,338 | 1,628,620 | 47,318 |
| Italy | 875,903 | 23,127 | 937,969 | 23,485 |
| Spain | 349,951 | 6,575 | 352,425 | 6,485 |
| Japan | 312,910 | 10,959 | 296,279 | 10,257 |
| Other | 795,905 | 395,909 | 413,314 | 22,226 |
| Total public finance | 23,149,961 | 9,858,041 | 13,792,062 | 459,057 |
| Structured finance: | | | | |
| Italy | 173,167 | 4,435 | 190,344 | 4,759 |
| Hungary | 92,297 | 89,323 | — | — |
| United Kingdom | 69,456 | 796 | 24,818 | 863 |
| United States of America | 66,724 | 6,672 | — | — |
| Germany | 7,344 | 269 | 9,264 | 338 |
| Total structured finance | 408,988 | 101,495 | 224,426 | 5,960 |
| Total | £ 23,558,949 | £ 9,959,536 | £ 14,016,488 | £ 465,017 |

## g. Significant business or other events that have occurred over the reporting period that have had a material impact on the undertaking and its subsidiaries

**Cross border merger with subsidiaries**

As noted above, the Company's financial resources and insured portfolio of risks have increased substantially during the year as a result of the Merger. The assets and liabilities transferred to AGE have been recognised at their carrying values, adjusted to conform to the accounting policies of the Company. The conforming adjustments increased the value of net assets transferred by £0.15 million.

The difference between the Company’s investment in group undertakings and the net assets transferred, including conforming adjustments, was recorded within equity under “other reserves”. The assets and liabilities transferred to AGE and the amounts recorded within other reserves are shown in the table below.

| As at 1 November | 2018 |
|---|---|
| | (in thousands) |
| Assets and liabilities acquired: | |
| Financial investments | £ 575,737 |
| Reinsurance assets | 43,431 |
| Debtors, including insurance receivables | 280,972 |
| Cash at bank | 23,560 |
| Deferred tax assets | 1,125 |
| Prepayments and accrued income | 11,467 |
| Insurance liabilities | (323,601) |
| Creditors, including reinsurance payables | (59,535) |
| Accruals and deferred income | (10,011) |
| Net assets recognised | 543,145 |
| Derecognition of investments in group undertakings | (322,880) |
| Other reserves recognised in equity | £ 220,265 |

**Brexit**
A principal uncertainty for the Company arising from the UK's planned exit from the EU is whether it will continue to be able to utilise passporting rights to conduct insurance activities within EEA countries after Brexit. In order to ensure that existing EEA based insurance policies can continue to be serviced and new EEA transactions can be entered into, in the event that passporting rights are not retained, the Company along with AGM is in the process of establishing a new company in France from which these activities will be conducted. If the Company's ability to service existing policies is not preserved, existing EEA policies will be transferred to the new company. In the case that the transfer of policies is not completed prior to the UK's departure, including where the UK leaves the EU without agreement on the terms of its exit (a "no deal Brexit"), it is the Company's belief that the risks posed will be significantly mitigated by measures recently announced by a number of EU countries which provide transitional arrangements for the servicing of existing policies.

## A.2 UNDERWRITING PERFORMANCE

**New business**
The Company measures new business production in terms of PVP. The Company believes PVP is a useful measure for management and other users of the financial statements because it enables the evaluation of new business production by taking into account the impact of the time value of money on estimated future instalment premiums.

New business written by the Company in 2018 and 2017 is shown in the table below**.** Gross par written refers to the value of debt principal insured at inception.

**New Business Written**

| Year Ended 31 December | 2018 | | | 2017 | | |
|---|---|---|---|---|---|---|
| | PVP | Gross Par Written | Number of Transactions | PVP | Gross Par Written | Number of Transactions |
| Sector | (in thousands, except number of transactions) | | | | | |
| Regulated utilities | £ 601 | £ — | 3 | £ 3,301 | £ 29,939 | 11 |
| Infrastructure | 10,966 | 25,047 | 5 | 2,692 | 53,383 | 7 |
| Total | £ 11,567 | £ 25,047 | 8 | £ 5,993 | £ 83,322 | 18 |

The Company provided financial guarantees during the year, which generated PVP of £11.6 million (2017: £6.0 million), an increase of 93% on prior year, and gross par written of £25.0 million (2017: £83.3 million). PVP in 2018 and 2017 comprises new transactions that were written using a co-insurance arrangement with AGM and also the restructuring of existing transactions which generated additional PVP but no additional par written.

## Underwriting result

The underwriting result of the Company for the year, as presented within the Company's financial statements, is summarised below.

**Technical Account for General Business**

| Year Ended 31 December | 2018 | 2017 |
|---|---|---|
| | (in thousands) | |
| Earned premiums, net of reinsurance | £ (7,595) | £ (13,552) |
| Net operating income | — | 767 |
| Other technical income | 1,595 | 65,269 |
| Total technical income (charge) | (6,000) | 52,484 |
| Net claims incurred | 903 | 6 |
| Net changes in other technical provisions | (2,772) | (34) |
| Net operating expenses | 499 | — |
| Total technical charges (income) | (1,370) | (28) |
| Balance on the technical account for general business | £ (4,630) | £ 52,512 |

The Company recorded negative earned premiums of £7.6 million (2017: negative £13.6 million). Negative net earned premiums arise from commutations with third party reinsurers for which gains arising on termination of the reinsurance agreement are recognised immediately but the subsequent reinsurance cessions under the quota share cover of the AGM Reinsurance

Agreement, made at the re-rated pricing of the risks, are earned over the life of reinsured policies. The termination of reinsurance with third party reinsurers during 2018 resulted in a gain of £1.6 million (2017: gain of £65.3 million).

The Company experienced net claims incurred during the year of £0.9 million primarily due to adverse developments in the performance of certain BIG transactions transferred to the Company as part of the Merger. The reduction in other technical provisions, net of reinsurance of £2.8 million was driven from favourable developments in the performance of certain other BIG transactions, including those assumed by the Company in the Merger.

The components of net operating expenses are shown in the table below.

**Net Operating (Expense) / Income**

| Year Ended 31 December | 2018 | 2017 |
|---|---|---|
| | (in thousands) | |
| Acquisition costs deferred | £ 525 | £ 67 |
| Change in deferred acquisition costs | (2,355) | (2,129) |
| Administration expenses | (11,546) | (9,083) |
| Reinsurance commissions | 12,877 | 11,912 |
| Net operating (expense) / income | £ (499) | £ 767 |

The Company incurred net operating expenses of £0.5 million (2017: net operating income of £0.8 million). Administration expenses were £2.5 million higher in 2018 due to increases in personnel, additional project related professional fees and business development expenditure. In addition, administration expenses recharged to AGE from other Assured Guaranty group companies increased from November 2018 following completion of the Merger.

## A.3 INVESTMENT PERFORMANCE

## Investment Portfolio

The portfolio of the Company consists primarily of high-quality, liquid, fixed income securities. The table below presents the Company's investment return for the year. All financial investments are held at fair value, with changes in valuation recognised within the income statement.

### a. Income and Expenses

**Investment Return**

| Year Ended 31 December | 2018 | 2017 |
|---|---|---|
| | (in thousands) | |
| Interest income: | | |
| UK Government bonds | £ 4,004 | £ 3,797 |
| Corporate bonds | 2,332 | 1,250 |
| Government guaranteed | 1,450 | 729 |
| Covered bonds | 493 | 444 |
| US Government bonds | 97 | — |
| Other | 19 | — |
| Total interest income | 8,395 | 6,220 |
| Net unrealised gain / (loss) on investments | (8,197) | (4,835) |
| Net realised gain / (loss) on investments | 41 | 8 |
| Investment expenses and charges | (316) | (173) |
| Total investment return | £ (77) | £ 1,220 |

The Company's interest income, predominantly derived from UK government bonds and highly rated corporate bonds, increased by 35% due to the increase in the investment portfolio as a result of the Merger. The investment yield (yield-to-maturity) of the portfolio as at 31 December 2018 was 2.05% (2017: 2.10%). The Company incurred net unrealised losses during 2018 and 2017 primarily as a result of widening corporate spreads and the continued upward trend in yields.

### b. Gains and Losses on Investments Recognised Directly in Equity

All investments gains and losses are recognised within the income statement.

### c. Investments in Securitisation

The Company held securitised assets as at 31 December 2018 representing 6% (2017: nil) of the investment portfolio. The securitised assets are primarily securities that are guaranteed by the Company and were purchased for loss mitigation purposes. Other securitised assets representing less than 1% of the investment portfolio (2017: nil) are US Agency mortgage-backed securities rated AA+.

## A.4 PERFORMANCE OF OTHER ACTIVITIES

The Company recorded other income totalling £0.5 million (2017: loss of £13.0 million) relating to foreign exchange, principally driven from gains on the Company's USD denominated assets following the strengthening of USD against GBP during the year.

## A.5 ANY OTHER INFORMATION

### *Lease Payments*

The Company leases and occupies office space in London and had the following future minimum lease payments under a non-cancellable operating lease agreement for each of the following periods:

**Future minimum lease payments**

| **Year Ended 31 December** | **2018** | **2017** |
|---|---|---|
| | **(in thousands)** | |
| Not later than one year | £ 529 | £ 271 |
| Later than one year and not later than five years | 2,118 | 2,118 |
| Later than five years | 3,040 | 3,570 |
| Total | £ 5,687 | £ 5,959 |

# B. SYSTEM OF GOVERNANCE

This section of the SFCR describes the principal components of the Company's management and governance structure, including its risk management processes.

## B.1 GENERAL INFORMATION ON THE SYSTEM OF GOVERNANCE

### a. Structure of the undertaking's administrative, management or supervisory body, main roles and responsibilities, segregation of responsibilities, committees, description of the main roles and responsibilities of key functions

### Administrative, Management or Supervisory Body

***Board of Directors***

The Company's Board has overall responsibility for the Company's system of governance, management of its business and affairs and for the establishment of its strategic direction and key financial objectives. The Company's board is comprised of three non-executive directors and four executive directors.

The Board has established an overall governance structure composed of the committees and functions shown in the diagram below to oversee and carry out standards, controls, limits, underwriting guidelines, risk management, audit, finance, capital and other policies and procedures approved by the Board. Each of the committees and functions operates under terms of reference, which are updated, reviewed and approved at least annually by the Board.

***Audit Committee***

The Audit Committee of the Company is comprised of the non-executive directors of its Board. The Audit Committee assists the Board with, among other things, the responsibilities listed below.

- Maintaining financial oversight through review of financial statements and internal controls.
- Monitoring the financial reporting process and submitting recommendations or proposals to ensure its integrity.
- Monitoring and overseeing the internal and external audit processes (in particular, the Internal Audit Function as an outsourced function).

The Audit Committee reports to the Board on its activities and findings at each of the regular quarterly meetings of the Board. The Finance Function, Internal and External Audit Function, provide reports to the Audit Committee, which in turn reports to the Board on the activities of those functions.

***Risk Oversight Committee***

The ROC of the Company is also comprised of the non-executive directors of its Board. The ROC assists the Board with, among other things, the responsibilities listed below.

- Overseeing management's establishment and implementation of standards, controls, limits, guidelines and policies relating to risk assessment and risk management.
- Ensuring that all material risks are effectively identified, monitored and managed in line with overall business strategy.
- Overseeing the risk management framework including: (i) the linkage between risk, capital and business decisions, (ii) the capital model, key capital model assumptions and results, major changes to the capital model, validation reports and capital model uses, (iii) the capital model governance policy and validation policy, (iv) stress and scenario tests, and (v) the ORSA.

The ROC reports to the Board on its activities and findings at each of the quarterly meetings of the Board. Each of the Surveillance Function and the Risk Management Function provide reports to the ROC, which in turn reports to the Board on the activities of those functions.

***Executive Committee***

The Board has delegated day to day management of the Company to an Executive Committee. Among other things, the Executive Committee establishes the Company's annual budget, reviews the Company's annual reports, financial statements and ORSAs and reviews its capital adequacy and reserves. The Executive Committee also reviews the other enterprise risk management activities, the surveillance of the individual risks in its portfolio as well as its governance framework. In addition, the Executive Committee reviews the compliance activities and evaluates, at least annually, the outsourcing arrangements for the Company.

The Reserve Committee, the Surveillance Committee, the Surveillance Function, the Risk Management Function, the Compliance Function and the Finance Function of the Company report to the Executive Committee, which in turn reports to the Board on its activities and findings.

## Key Functions

The system of governance for the Company includes the four Key Functions (risk management, compliance, internal audit and actuarial) specified in the Directive. Below is a brief description of the main roles and responsibilities of those Key Functions.

### *Risk Management Function*

The Risk Management Function has responsibility for ensuring that the Company has in place an effective risk management system comprising strategies, processes and reporting procedures necessary to identify, measure, monitor, manage and report on risks on a continuous basis at both the individual and aggregate levels to which the Company is or could be exposed, and their interdependencies. The responsibilities of the Risk Management Function are further detailed in Section B.3.

The Risk Management Function is independent of any business or operational unit.

### *Internal Audit Function*

The Internal Audit Function is responsible for providing the Company with independent, objective assurance and advisory services. The primary responsibility of the Internal Audit Function is to provide independent assurance over the adequacy and effectiveness of the internal control system within the Company and other elements of the Company's system of governance.

The Company outsources the Internal Audit Function to an international public accounting firm, which is objective and independent from the Company's operational functions. The Internal Audit Function reports directly to the Audit Committee and Board on the results of its internal audit activities and any other internal audit matters.

### *Compliance Function*

As part of its Risk Management Framework, the Company has a Compliance Function, which advises the Board on compliance with applicable laws and regulations, including the Directive and the Solvency II Regulation, makes an assessment of the possible impact of any changes in the legal environment on the operations of the Company, and identifies and assesses compliance risk. In carrying out those responsibilities, the Compliance Function maintains an open relationship with the PRA and the FCA and implements internal compliance procedures in line with the guidelines and recommendations of those regulators. The Compliance Function is independent from any business or operational unit and carries out its functions on its own initiative. *Section B.4.b* provides further detail on the activities of the Compliance Function.

### *Actuarial Function*

The Company has outsourced the Actuarial Function to the Chief Actuary for AGM. The Chief Actuary carries out the responsibilities of the Actuarial Function, including those set out in Article 48 of the Directive. The Chief Actuary has a broad range of actuarial experience including extensive experience evaluating the losses for financial guarantees and other structured products; developing and using capital models, pricing esoteric lines of business, and evaluating loss mitigation strategies. *Section B.6* provides further detail on the activities of the Actuarial Function.

## b. Material changes in the system of governance over the reporting period

Solvency II contains a regime for the supervision of groups, including groups in which the parent undertaking has its head office in a country that is outside the EEA. The treatment of such groups in part depends on whether the jurisdiction in which the non-EEA parent has its head office is determined to have a supervisory regime which is equivalent to the Solvency II regime. In the absence of such a determination, the Solvency II rules on supervision apply to the group on a worldwide basis, unless the PRA elects to apply “other methods”, which ensure appropriate supervision.

AGE is a direct subsidiary of a US parent company, AGM. As noted above, AGM's primary supervisor, the NYDFS has agreed to serve as the group regulator for the insurance companies in the AGL Group.

The PRA has elected to apply "other methods" to AGE to ensure appropriate supervision. In 2018, in connection with the implementation of the EU-US Covered Agreement, the PRA issued a new Direction to AGE setting out its requirements. These include, among other things, requirements for AGE to provide the PRA with certain information in relation to the group's risk management, risk exposures and solvency assessment. The Direction applies from 12 November 2018 until 1 October 2021, unless it is revoked earlier or no longer applicable.

The Company implemented changes to its management responsibilities to reflect the extension of the Senior Managers and Certification Regime to the insurance and reinsurance sectors from 10 December 2018. There were no other material changes in the Company's system of governance during the year. The systems of governance of AGUK, AGLN and CIFGE were generally consistent with those of the Company, and operated by persons also performing such roles for the Company. As such, the Merger did not materially impact on the Company's governance.

## c. Remuneration policy and practices

### i. Principles of the remuneration policy, with an explanation of the relative importance of the fixed and variable components of remuneration

The Company ensures that it has appropriate remuneration arrangements through the adoption of a remuneration policy.

The Company's remuneration policy is grounded in the concept of attracting and retaining talented and experienced business leaders who can drive financial and strategic growth objectives intended to build long-term shareholder value while protecting the interests of policyholders. The guiding principles are:

- pay for performance by providing an incentive for exceptional performance and the possibility of reduced compensation for underperformance,
- accountability for short and long-term performance,
- alignment to shareholder interests, and
- retention of highly qualified and successful employees.

The Company's remuneration principles are designed to assess performance, using pre-established measures of success that are tied to the key business strategies. The principles encourage balanced performance, measured relative to financial and non-financial goals, and discourage excessive risk taking or undue leverage by avoiding too much emphasis on any one metric or on short-term performance.

The Company's remuneration principles have been designed to reward performance by providing more variable and performance-based remuneration to senior management of the Company. The principles employ a mix of variable incentive compensation with various pay-out forms paid over staggered time horizons to provide an incentive for annual and sustained performance over the longer term. Most of the remuneration of the most senior personnel consists of variable incentive compensation, in the form of an annual cash incentive as well as long-term equity incentives.

When the remuneration principles were developed, they were evaluated for any areas of risk or potential for unintended consequences and also evaluated relative to enterprise risks. AGE's remuneration principles are designed and administered with the appropriate balance of risk and reward in relation to the overall business strategy and do not encourage executives to take unnecessary or excessive risks that could have a material adverse impact on the Company.

Remuneration consists of three principal elements: base salary, cash incentive remuneration and long-term incentive compensation. The Company's remuneration principles are structured with upside potential for high performers, but also the possibility of reduced remuneration if individuals under-perform (e.g. they are unable to successfully execute group strategies or meet their business or regulatory obligations). The Company's remuneration principles include a recoupment (claw back) policy pursuant to which a portion of the remuneration of certain members of senior management of the Company, may be rescinded or recouped if such person engages in misconduct related to a restatement of financial results or of objectively quantifiable performance goals, and the achievement of those goals is later determined to have been overstated.

The non-executive directors of the Company's Board receive a fixed fee.

### ii. Criteria on which any entitlement to share options, shares or variable components of remuneration is based

In addition to base pay, certain members of senior management may be eligible for a cash incentive award. The amount of the cash incentive is determined using a formulaic approach and is based on the extent to which an executive achieves five financial performance goals and other non-financial objectives. Cash incentive awards, if awarded, are paid the year following the performance year on which they are based.

AGL also maintains a LTIP, which was designed to enable its subsidiaries, including the Company, to attract and retain employees who contribute to the Company's success by their ability, ingenuity and industry, and to enable those employees to participate in the long-term growth of AGL and its subsidiaries. A LTIP award may be made in the form of non-qualified and incentive stock options, stock appreciation rights, full value awards, which include awards such as restricted shares, restricted stock units or performance share units, and cash incentive awards. Awards are made at the discretion of AGL's Compensation Committee, in consultation with, the Company's Board. For certain senior management of the Company, LTIP awards can be made in the form of performance share units, which represent a contingent right to receive up to 2.5 of AGL's common shares. For performance share units granted through 2018, the number of common shares an individual can earn is based on whether the highest average stock price achieved during a 40 consecutive trading day sequence occurring during the last 18 months of a 3 year performance period exceeds certain share price hurdles. For performance share units granted in 2019, the number of common shares an individual can earn is based on growth in core adjusted book value per share relative to total shareholder return relative to the Russell Midcap Financial Services Index. LTIP for certain senior management also can be awarded in the form of restricted stock units, which represent the right to receive one of AGL's common shares at the end of a three-year vesting period. The form of LTIP awards may change at any time. For other personnel who are granted awards, the awards are made in the form of restricted stock, which vests over a three or four year period.

### iii. Supplementary pension or early retirement schemes for the members of the administrative, management or supervisory body and other key function holders

AG (UK) Services and AGUS Services provide employees the opportunity to participate in a defined contribution pension scheme, which is designed to help their respective employees prepare for retirement by allowing them to contribute a percentage of their remuneration to the scheme and by matching an employee's contribution up to a certain amount. Employees of AG (UK) Services or AGUS Services who serve as executive directors of the Company, who hold SMFs or key functions are also permitted to participate in the scheme. The Company does not provide any supplementary pension or retirement schemes for non-executive members of the Board.

## d. Material transactions during the reporting period with shareholders, persons who exercise a significant influence on the undertaking, and members of the administrative, management or supervisory body

The Company did not have any material transactions during the reporting period with members of its Board or management.

### Reinsurance and Support Agreements

The Company is party, with its parent company AGM, to the AGM Net Worth Maintenance Agreement and the AGM Reinsurance Agreement. It is also party to other reinsurance agreements with affiliated AGL Group companies. Please refer to *Section E.1* for additional information on these agreements.

### Management, Service Contracts or Cost Sharing Arrangements

#### *Service Agreement with AGUK Services*

The Company is party to a services agreement with AG (UK) Services pursuant to which AG (UK) Services provides professional insurance executives and administrative and clerical personnel who are experienced in the management of insurance operations similar to the Company's operations. Under such agreement, the Company pays to AG (UK) Services a fee equal to the costs incurred by AG (UK) Services in providing the services of those individuals plus a mark-up.

#### *Service Agreement with AGUS Services*

In addition, the Company is also party to the Group Service Agreement. Under the Group Service Agreement, the Company's US affiliates make services available to the Company, including actuarial, marketing, underwriting, claims handling, surveillance, legal, compliance, corporate secretarial, information technology, human resources, accounting, tax and investment planning services. Expenses under the Group Service Agreement are allocated directly where appropriate and, where not appropriate, based upon an allocation of employee time and corresponding office overhead.

## B.2 FIT AND PROPER REQUIREMENTS

### a. Requirements concerning skills, knowledge and expertise applicable to the persons who effectively run the undertaking or have other key functions

The Company ensures that all persons who effectively run or oversee the Company, or who hold a SMF for the Company or a Key Function, are able to provide competent and prudent management through the assessment process described below. Each person is assessed at the time they enter into a non-executive role or are first hired by AG (UK) Services or AGUS Services, as the case may be.

### b. Process for assessing the fitness and the propriety of the persons who effectively run the undertaking or have other key functions

Non-executives who are considered for appointment to the Company's Board go through a rigorous internal vetting process including interviews with senior management and members of the Board of AGL. Employees of AG (UK) Services or AGUS Services who are considered for SMF roles or as KFHs are subject to additional scrutiny prior to commencement of that role. In addition, the Company obtains the background checks and references required by its internal policies and regulation.

The Company's assessment of whether an individual is fit includes an assessment of the person's professional qualifications, knowledge and experience for the position and the person's:

- understanding of the financial guarantee business,
- honesty, integrity, and reputation,
- judgement, competence and capability, and
- financial soundness.

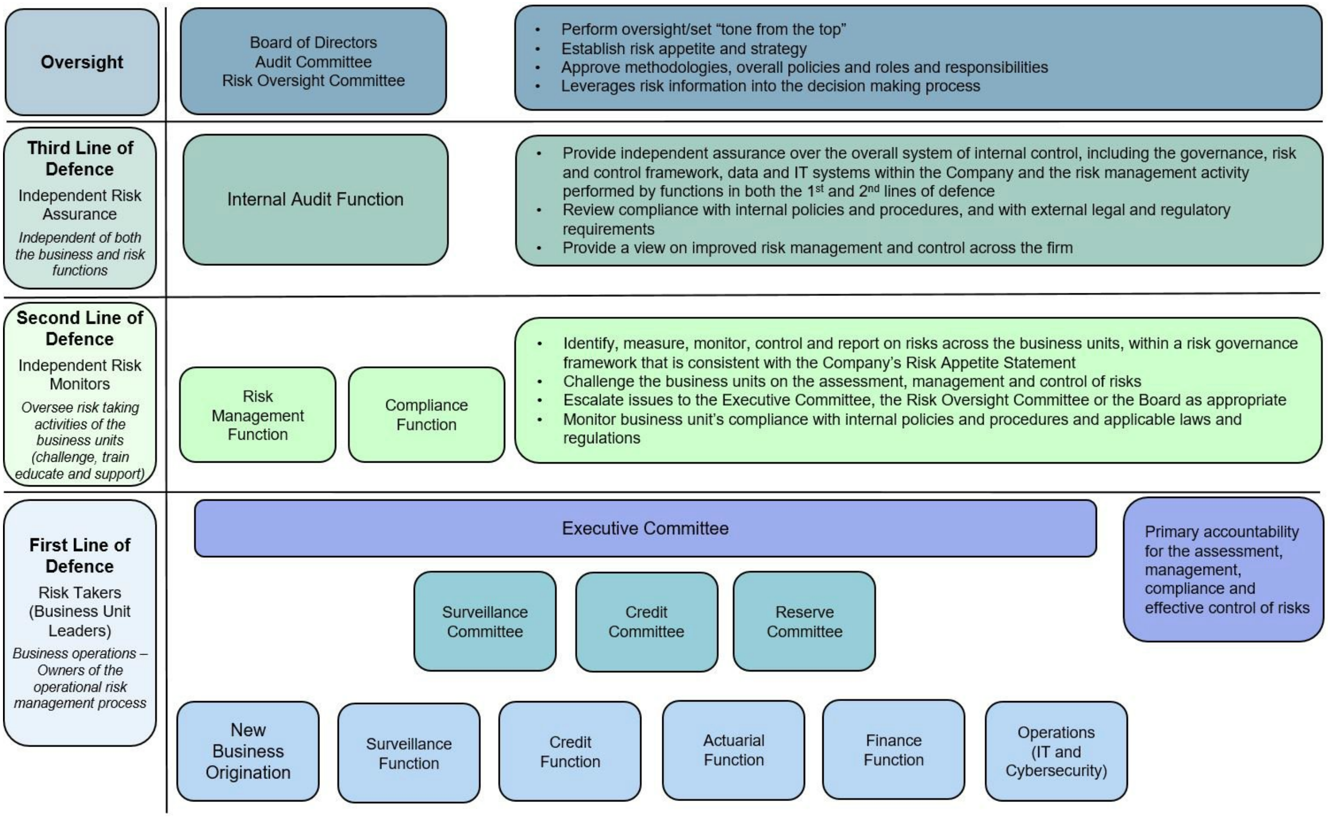
Members of the Company's Board and individuals who hold SMFs, or Key Functions are required to complete training at the inception of their role and thereafter training on an ongoing basis, which is appropriate to their regulatory roles and responsibilities and to the professional competencies required for their specific position.

The Company's assessment of whether an individual is proper includes consideration of criminal and regulatory offences.

## B.3 RISK MANAGEMENT SYSTEM

### a. Risk Management

The Company's risk management system is based around the three lines of defence model which ensures that all functions, both those that own risks as well as the Risk Management and Compliance Functions, are responsible for managing risks.



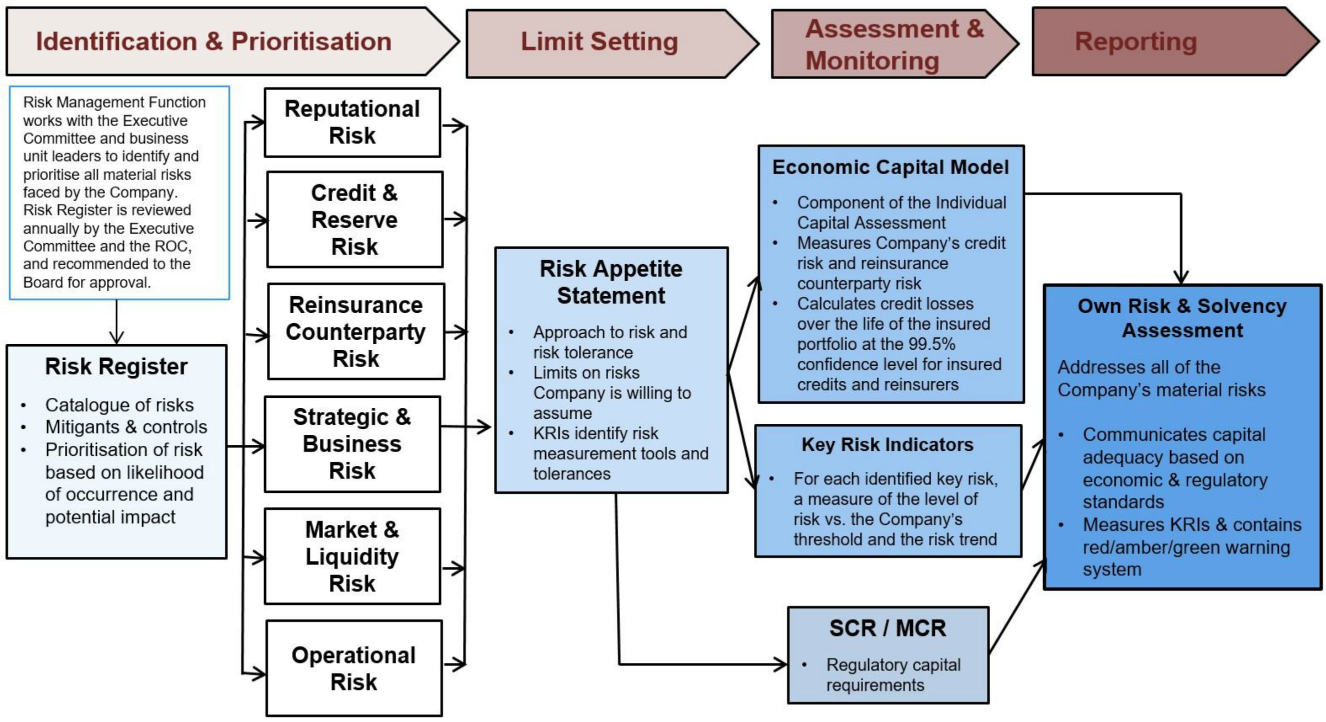

*Section B.1.a* describes how the various lines of defence are integrated into enterprise-level decision-making, corporate oversight and management of the daily operations of the Company, as well as the roles and responsibilities of the Internal Audit Function and the Compliance Function in administering the three lines of defence model. The remit of the Compliance Function is described in *Section B.4.b* and that of the Internal Audit Function is described in *Section B.5.*

The Board and ROC of the Company play a critical role in the risk management of the Company. Under the direction of the Board, the ROC is responsible for overseeing management's execution of the Company's risk assessment and risk limits, guidelines and policies, addressing the linkage between risk, capital planning and business decisions. The ROC oversees the creation and maintenance of the Risk Register, Risk Appetite Statement and ORSA, including recommending them to the Board for approval, development of the ICA model and the design of stress and sensitivity testing. Regular ORSA reporting to the Board and ROC keeps them continually aware of the information needed to develop informed business strategy and capital management plans, as well as to refine the Company's risk appetite to reflect actual or potential capital constraints.

The Risk Management Function is responsible for the operational aspects of risk management for the Company, including:

- implementing the risk management framework
- assessing the risk profile
- maintaining the Risk Register
- updating the Risk Appetite Statement
- developing and preparing the ORSA
- maintaining the ECM
- performing scenario and stress testing on the Company's capital ratios
- analysing the impact of potential emerging issues
- identifying and reporting on any material risk issues to the Executive Committee, and
- determining the impact on the ECM of proposed transactions, including acquisitions and changes in reinsurance arrangements.

The Risk Management Function follows the framework set out below in executing its responsibilities.




*1. Risk Register*

The Risk Management Function works with business unit leaders to ensure that all known risks are identified and to work cooperatively on determining the importance of these risks and the most effective ways to measure them. The business units maintain ownership, accountability and responsibility for the risks arising in their respective areas. The results of the risk identification process are documented in the Company's Risk Register which provides, for each risk, the risk indicators or drivers; the likelihood of the risk occurring and its impact, both as an inherent risk and a residual risk, i.e., after consideration of controls and risk mitigants in place to minimise the risk; and the area responsible for the risk. The Company's Risk Register is updated by the Risk Management Function together with the Executive Committee annually. The Company's Risk Register is subject to review and challenge by the ROC and is approved by the ROC and the Board.

*2. Risk Appetite Statement*

The Company's Risk Appetite Statement describes the types of risks the Company is willing to accept, sets forth risk tolerances as appropriate, prohibits the execution of certain kinds of transactions and sets certain portfolio concentration limits. The Executive Committee of the Company works with the Risk Management Function to update its Risk Appetite Statement annually, and it is subject to review and challenge by the ROC and approved by the Board.

*3. ORSA Process*

The three main components of the Company's ORSA process are the Key Risk Indicators, the Individual Capital Assessment and the ORSA report.

*(i) Key Risk Indicators*

The Company developed a series of KRIs to measure its material risks, working in consultation with its business unit managers to ensure that the KRIs both properly capture the material risks as set forth in the Risk Register and use effective techniques for risk measurement. The KRIs are prioritised by the likelihood of the risk occurring over the Company's business planning horizon or beyond, and the potential severity of the impact that each risk would have on the Company if it were to occur. In addition, the KRIs address trends in the Company's business, e.g., financial, economic and credit, that would be leading indicators, positive or negative, of possible changes in solvency over time. The Company developed thresholds to measure its KRIs and reports on those measures each time it prepares its ORSA, assigning each KRI a rating of green (comfortably within the Company's risk tolerance), amber (within the Company's risk tolerance but warrants attention) or red (outside the Company's risk tolerance). Management actions are identified to address any amber or red KRIs. The Company reports on the KRIs quarterly, and reviews and updates them annually to ensure that they continue to provide a relevant, appropriate and comprehensive assessment of material risks.

*(ii) Individual Capital Assessment & Economic Capital Model*

To calculate what it believes to be its true economic risk for its respective ORSA, the Company uses its ICA. The ICA employs an internally developed model, the ECM, to measure its key risks, i.e., credit/underwriting risk and reinsurance counterparty risk. The Company uses the Standard Formula for the calculation of the less material risk components of its ICA: strategic & business risks, market & liquidity risks and operational risks.

The Risk Management Function is responsible for the design, testing, validation and implementation of the ICA, including the ECM. In designing parameters and assumptions for use in the ECM, Risk Management consulted with the Company's senior managers. At the time of initial design, and from time to time and after material methodology changes, the ECM has been validated by an outside consulting firm, finding that the core methodology appeared sound and broadly in line with industry practices for credit economic capital modelling. Risk Management regularly works with the Company's senior managers to re-evaluate and update the ICA and ECM to ensure that they continue to satisfactorily address the Company's key risks.

Changes to the ECM are governed by the Company's Model Validation Policy which requires that model changes are subject to validation, and that the scope of the validation process and reporting should be appropriate to the nature, extent and complexity of the changes. Changes that are not material are approved by the Executive Committee and require notification to the ROC and the Board. Material changes are reviewed by the Executive Committee and ROC and approved by the Board.

*(iii) ORSA Report*

The Company documents the results of its risk management activities described above in an ORSA report, which is the Company's principal tool to inform management and the Board about all reasonably foreseeable and relevant material risks, both quantitative and qualitative. The ORSA is intended to provide a complete picture of the Company's risk profile and capital adequacy relative to these risks, present the overall solvency needs and solvency condition taking into account its risk profile, risk appetite and business strategy and demonstrate compliance, on a continuing basis, with internal and regulatory capital requirements. The Company produces its ORSA quarterly, and will produce it more frequently if there is a material change in its risk profile or other events that warrant an off-cycle review.

The results of the ORSA are presented to the Executive Committee and the ROC quarterly for review and challenge. Each of the Executive Committee, the ROC and the Board approve the ORSA Report annually.

## B.4 INTERNAL CONTROL SYSTEM

### a. A description of the undertaking's internal control system

The Company has put in place an effective internal control system, the policies and procedures in respect of which are documented within the Company's Internal Control Policy. The Company's control framework is based upon four key components:

- *Control environment* - the overall control culture is established by the Company's management and its key governance functions. The Company's Code of Conduct sets forth standards by which the Company's directors, and all personnel acting as officers or otherwise providing services to the Company, must abide and sets the tone for how personnel supporting the Company should conduct themselves. The Code of Conduct is available at www.assuredguaranty.com/governance. The Code of Conduct is designed to discourage personnel from engaging in activities that could jeopardise the Company's business and reputation;
- *Control activities* - the Company's key controls have been identified and are designed to provide reasonable assurance that material errors will be prevented or detected on a timely basis;
- *Information and communication* - the design of information and reporting provided to both control operators and reviewers is assessed as part of control design. The appropriateness of information provided is assessed as part of control monitoring;
- *Monitoring* - the Company is part of the AGL Group which as a public company is subject to the requirements of Sarbanes-Oxley. As such, the Company's controls are subject to annual testing, with a management testing plan developed for relevant key controls. The Internal Audit Function is also responsible for assessing the effectiveness of the Company's internal controls.

### b. Description of how the Compliance Function is implemented

The Company does not have a separate compliance department whose sole remit is monitoring compliance-related activities. The Compliance Function for the Company is carried out by a compliance professional dedicated to the Company and by the

General Counsel and Chief Compliance Officer of the Company and is overseen by the General Counsel of AGL who is the Key Function Holder for Compliance.

The Compliance Function for the Company is responsible for reporting any breaches, or non-compliance with applicable law and regulation, to the Executive Committee and the ROC of the Company.

The principal activities of the Compliance Function are:

- Advising on compliance with applicable laws and regulations and assessing the possible impact of new laws and regulations.
- Ensuring that new regulatory rules and internal guidelines are communicated to the affected business areas and providing guidance to those business areas in respect of such requirements.
- Maintaining an open dialogue with applicable regulators, and submitting the appropriate information to those regulators, including notice of matters that are of concern to the regulators.
- Ensuring that all relevant personnel complete training on their regulatory roles and responsibilities, and on compliance with applicable laws and regulations, on a regular basis (including anti-money laundering and anti-bribery/corruption training).
- Assessing, together with the Internal Audit Function, the adequacy and effectiveness of compliance controls.

The Compliance Function works with the Internal Audit Function to develop an internal audit plan that addresses, as appropriate, compliance by the Company with internal policies and procedures. The Internal Audit Function is responsible for monitoring compliance with internal strategies, processes and reporting procedures. *Section B.5* describes the Internal Audit Function in more detail. The Company's compliance program is also integrated with the AGL Group's compliance program, which includes reporting compliance violations or significant issues.

The Compliance Function for the Company is independent from any business or operational unit.

## B.5 INTERNAL AUDIT FUNCTION

### a. How the undertaking's Internal Audit Function is implemented

The Internal Audit Function is responsible for providing the Company with independent, objective assurance and advisory services. The Internal Audit Function performs activities including: evaluation of risk management and control, and governance processes. The Internal Audit Function is independent of any other function and has access to any member of staff and to any information it considers necessary to carry out its duties. Independence is maintained by segregation from other functions where possible and by safeguards and review where this is not possible. On a quarterly basis, or when required, the Internal Audit Function reports its findings directly to the Company's Audit Committee and informs the CEO of any material issues.

The Company have concluded that, at this time, the Internal Audit Function is most effective being outsourced to an external firm of certified internal audit professionals. The Company maintains responsibility for management of the Internal Audit Function.

Internal audit resources are focused on testing the key controls that mitigate business risk. If requested, the Internal Audit Function may also provide the Company with advice, support and assistance. The internal audit plan is developed with the input of and review from the Audit Committee.

The Internal Audit Function evaluates the design and operating effectiveness of the Company's network of risk management, control and governance processes, as designed and represented by management, to validate that:

- risks are appropriately identified and managed,
- interaction with the various governance groups occurs as needed,
- 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,
- quality and continuous improvements are fostered in the control processes,
- significant legislative or regulatory issues impacting the organisation are recognised and addressed appropriately,
- systems established to operate and comply with policies, plans, procedures, laws, and regulations which could have a significant impact on operations and reports are designed and operating appropriately,
- that key risks are addressed and to ensure that audit duplication with external auditors is avoided whenever possible, and
- controls are implemented to reduce the risk of fraud and misappropriation of assets.

### b. How the Internal Audit Function maintains its independence and objectivity from the activities it reviews

The Internal Audit Function remains independent of and objective from other functions of the Company primarily through outsourcing the Internal Audit Function to an external party who is not involved in the operations that are subject to internal audit activities. To provide an appropriate level of organisational independence, the Internal Audit Function reports functionally to the chairman of the Audit Committee and administratively to the head of the Risk Management Function.

## B.6 ACTUARIAL FUNCTION

The Actuarial Function has been outsourced to the Chief Actuary of AGM. The Chief Actuary's responsibilities include:

- proposing loss reserves to the Reserve Committee,
- coordinating the calculation of Technical Provisions,
- reviewing the Company's ICA model,
- reviewing assumptions, methods, and data used in modelling,
- contributing to risk modelling,
- monitoring differences in Technical Provisions in different years,
- drawing conclusions and comparing actual results to expected values,
- reporting to the Board on the adequacy of the calculation of Technical Provisions,
- opining on underwriting policy and adequacy of reinsurance, and
- making any recommendations on how any shortcomings can be remedied.

The Chief Actuary is a qualified actuary in good standing with the Casualty Actuarial Society, and is also a Fellow in the Casualty Actuarial Society. In addition, the Chief Actuary is a member of the American Academy of Actuaries in good standing. Refer to *Section B.1* for a summary of how the Actuarial Function is integrated into the risk management framework for the Company.

## B.7 OUTSOURCING

Given the relatively small size of the Company's operations and the desire to ensure the efficiency and effectiveness of its operations, the Company has determined that certain functions should be outsourced to one or more affiliates, or third parties. The Company remains fully responsible for discharging its legal and regulatory obligations notwithstanding such outsourcing arrangements.

### Outsourcing to Companies within the AGL Group

The Company outsources certain functions to its affiliates pursuant to service agreements with AG (UK) Services (domiciled in the UK) and AGUS Services (domiciled in the US). These arrangements are described in S*ection B.1.d*.

Employees of AG (UK) Services and AGUS Services who are performing outsourced functions are not empowered to make underwriting decisions on behalf of the Company or to bind the Company in any way.

### Outsourcing to Third Parties

#### *Investment Management*

The Company outsources the management of its respective investment portfolio to third party investment managers. Each investment manager manages the investment portfolios of the Company in accordance with their respective investment guidelines. The Company's investment guidelines are designed to minimise credit risk and to ensure ample liquidity to cover losses in a stress scenario.

#### *Internal Audit*

The Company outsources its Internal Audit Function to an international public accounting firm. The role and responsibilities of the Internal Audit Function are described in further detail in *Sections B.1.a* and *B.5*.

## B.8 ANY OTHER INFORMATION

### a. Assessment of the Company’s system of governance relative to the nature, scale and complexity of the risks inherent in its business

The Board of the Company formally assesses the adequacy of its system of governance on an annual basis. The Board may also recommend changes outside of this annual review as a result of observations or regulatory changes. The Board of the Company has reviewed the governance system as described in this report and concluded that it provides for sound and prudent management of the business which is proportionate to the nature, scale and complexity of the operations.

### b. Any other material information regarding system of governance

None.

# C. RISK PROFILE

This section of the SFCR provides information on the material risks faced by the Company, which include underwriting risk, counterparty risk, market risk, liquidity risk and operational risk.

## C.1 UNDERWRITING RISK

Financial guarantee insurance protects holders of debt instruments and other monetary obligations from defaults in scheduled payments. As a result, the Company's key underwriting risk is credit risk, i.e., the risk that obligors of insured debt obligations will fail to pay. The policies issued by the Company are non-cancellable generally, with the premiums paid up front, in instalments, or a combination of both. The obligation to make claim payments generally cannot be accelerated, although the Company generally retains the right to accelerate payment on defaulted obligations. The Company has no life or health underwriting risk or any other general insurance underwriting risk.

### Measurement

The Company's main metrics for measuring insured credit risk (in addition to the Risk Management and ORSA processes, discussed in *Section B.3)* are par outstanding, by sector and internal rating. The Company also considers geographic concentrations. At the closing of each transaction, the UK Credit Committee assigns the transaction to a sector (i.e., a group of transactions with similar risk characteristics) for purposes of evaluating risk and potential correlations. The UK Credit Committee also assigns an internal credit rating reflecting the credit quality of the transaction, with such rating subject to change over time. The Surveillance Function is responsible for monitoring the performance of all insured transactions and recommending internal rating changes as appropriate. All rating changes must be approved by the RMC.

The Company's insured portfolio, and therefore its exposure to underwriting risk, has increased during the year on both a gross and net basis, as a result of the Merger. The Company's insured portfolio split by sector, as measured by GPO and NPO, as at 31 December 2018 and 2017, is set out below.

**Insured Portfolio by Sector**

| **As at 31 December** | **2018** | | | **2017** | | |
|---|---|---|---|---|---|---|
| | **Number of Risks** | **GPO** | **NPO** | **Number of Risks** | **GPO** | **NPO** |
| **Sector** | **(in thousands, except number of risks)** | | | | | |
| Regulated utilities | 51 | £ 10,233,689 | £ 4,283,192 | 45 | £ 6,146,799 | £ 193,948 |
| Public infrastructure | 65 | 9,891,029 | 4,228,106 | 46 | 6,064,928 | 222,241 |
| Other public finance | 19 | 3,025,243 | 1,346,743 | 12 | 1,580,336 | 42,867 |
| Total public finance | 135 | 23,149,961 | 9,858,041 | 103 | 13,792,063 | 459,056 |
| RMBS | 9 | 342,264 | 94,823 | 5 | 224,426 | 5,960 |
| Insurance securitisation | 2 | 66,724 | 6,672 | — | — | — |
| Total structured finance | 11 | 408,988 | 101,495 | 5 | 224,426 | 5,960 |
| Total portfolio | 146 | £ 23,558,949 | £ 9,959,536 | 108 | £ 14,016,489 | £ 465,016 |

The table above excludes £625.2 million of GPO and £62.5 million of NPO as at 31 December 2018, attributable to loss mitigation strategies.

The breakdown of the Company's insured portfolio by internal ratings as at 31 December 2018 and 2017, is set out below. The ratings given are the Company's internal rating classifications which may or may not differ from those of the Rating Agencies.

**Portfolio Breakdown by Internal Credit Rating**

| As at 31 December | 2018 | | 2017 | |
|---|---|---|---|---|
| | GPO | NPO | GPO | NPO |
| Internal Credit Rating | (in thousands) | | | |
| AAA | £ 50,375 | £ 93 | £ 4,094 | £ 103 |
| AA | 67,316 | 20,466 | 49,581 | 1,266 |
| A | 8,082,145 | 4,976,259 | 3,572,289 | 96,867 |
| BBB | 14,536,060 | 4,756,481 | 9,807,595 | 356,494 |
| BIG | 823,053 | 206,237 | 582,930 | 10,286 |
| Total | £ 23,558,949 | £ 9,959,536 | £ 14,016,489 | £ 465,016 |

The table above excludes £625.2 million of GPO and £62.5 million of NPO as at 31 December 2018, attributable to loss mitigation strategies.

The table below sets out the Company's BIG transactions, by GPO and NPO, split between Public Finance and Structured Finance as at 31 December 2018 and 2017. The Company has a total of nine BIG risks as at 31 December 2018 compared to a total of four BIG risks as at 31 December 2017. The five transactions added to the BIG list during the year were transferred to the Company as a result of the Merger.

**BIG Exposure by Sector**

| As at 31 December | 2018 | | | 2017 | | |
|---|---|---|---|---|---|---|
| | PF | SF | Total | PF | SF | Total |
| | (in thousands, except number of risks) | | | | | |
| Number of risks | 6 | 3 | 9 | 4 | — | 4 |
| GPO | £ 720,970 | £ 102,083 | £ 823,053 | £ 582,930 | £ — | £ 582,930 |
| NPO | 164,206 | 42,031 | 206,237 | 10,286 | — | 10,286 |

As at 31 December 2018, the Company had established loss reserves or unexpired risk provisions for the BIG transactions on which it expects to incur a loss, and had paid claims on two of the BIG transactions during the year.

## Risk Concentration

The table below shows the geographic concentrations of insured obligations, by GPO and NPO, as at 31 December 2018.

**Geographic Distribution of Gross and Net Par Outstanding**

| As at 31 December | 2018 | | 2017 | |
|---|---|---|---|---|
| | GPO | NPO | GPO | NPO |
| Country | (in thousands) | | | |
| United Kingdom | £ 18,418,188 | £ 8,338,929 | £ 10,188,273 | £ 350,148 |
| Europe, excluding UK | 4,498,517 | 1,378,357 | 3,494,935 | 103,548 |
| Other | 642,244 | 242,250 | 333,281 | 11,320 |
| Total | £ 23,558,949 | £ 9,959,536 | £ 14,016,489 | £ 465,016 |

The table above excludes £625.2 million of GPO and £62.5 million of NPO as at 31 December 2018, attributable to loss mitigation strategies.

Concentration risk by sector is shown within 'Measurement' above.

## Risk Mitigation

***Underwriting & Credit Procedures***

The Company applies its credit underwriting judgement, risk management skills and capital markets experience to manage its credit risk. The Company has a framework and procedures in place for establishing and implementing underwriting guidelines and single risk and risk concentration limits across its insured portfolio, as well as procedures for ensuring that these guidelines and limits are adhered to in the transaction approval process. The Company seeks to limit its exposure to losses by underwriting obligations that it deems to be IG at inception, although, as part of a loss mitigation strategy for any troubled credits, it may underwrite new issuances that it views as BIG. The Company diversifies its insured portfolio across asset classes and, in the structured finance portfolio, requires rigorous subordination or collateralisation requirements.

Each transaction must be approved by the Credit Committee, which is composed of the CEO of the Company, the Chief Credit Officer of the Company and the Chief Credit Officer of AGM. Within the parameters delegated to it by the PRMC, the Credit Committee establishes credit standards, underwriting processes and controls that govern transactions, and has the sole authority at the Company level, to review and approve or reject all transactions undertaken by the Company. As part of the approval process, the Credit Committee enforces the single risk and credit concentration limits established by the Board. It also incorporates into the underwriting process critical feedback provided by the RMC on the performance of, and any problems related to, transactions in the Company's insured portfolio.

Because of the strong relationship of the Company to its parent, including the co-insurance arrangement for all transactions underwritten by AGE from 2011, the second-to-pay guarantee of all of the Company's insured transactions by AGM, the AGM Net Worth Agreement and the excess of loss cover of the AGM Reinsurance Agreement, all transactions executed by the Company are subject to two levels of review and approval by the Credit Committee and by the ISCC of the parent company. The ISCC is composed of senior officers of the AGL Group with credit expertise relevant to the type of transaction under consideration. Both committees must approve each transaction.

***Surveillance***

The Company performs regular monitoring of the performance of each insured transaction throughout its life and also tracks the aggregation of risk across the portfolio, to provide early identification of any credit concerns. The review cycle and scope for transactions varies based upon transaction type and credit quality. In general, the review process includes the collection and analysis of information from various sources, including trustee and servicer reports, financial statements, general industry or sector news and analyses, and rating agency reports. For public finance and structured finance risks, the surveillance process includes monitoring general economic trends, developments with respect to the financial situation of the issuers, performance data and cash flows, compliance with transaction terms and conditions, and evaluation of servicer or collateral manager performance and financial condition.

The internal credit ratings assigned to all transactions are based on internal assessments of the likelihood of default and loss severity in the event of default. Internal credit ratings are expressed on a ratings scale similar to that used by the Rating Agencies and are generally reflective of an approach similar to that employed by the Rating Agencies, except that the Company's internal credit ratings focus on future performance rather than lifetime performance.

The Company segregates its insured portfolio into IG and BIG surveillance categories to facilitate the appropriate allocation of resources to monitoring and loss mitigation efforts and to aid in establishing the appropriate cycle for periodic review for each exposure. BIG exposures include all exposures with internal credit ratings below "BBB-". The Company monitors its IG credits to determine whether any need to be internally downgraded to BIG and refreshes its internal credit ratings on individual credits in quarterly, semi-annual or annual cycles based on the Company's view of the credit's quality, loss potential, volatility and sector. Ratings on credits identified as under the most stress or with the most potential volatility are reviewed every quarter.

The Surveillance Function provides comprehensive reporting to senior management through the RMC. Generally, transactions are reviewed and presented to the RMC in sector reports, which group together transactions that share common risk characteristics. Reviewing credits by sector facilitates comparison of performance, risk ranking and early identification of underperforming transactions. In addition, each quarter, the Surveillance Function prepares and presents a quarterly risk management review to the ROC and Board.

### *Workout Activities*

Surveillance officers are responsible for managing workout and risk mitigation strategies. They work together across the AGL Group to develop and implement strategies on transactions that are experiencing losses or could possibly experience losses. They develop strategies designed to enhance the ability of the Company to enforce its contractual rights and remedies and mitigate potential losses. Surveillance personnel also engage in negotiation discussions with transaction participants (along with workout personnel) and, when necessary, manage (along with legal personnel) any potential litigation proceedings. The Company may also make open market or negotiated purchases of securities that it has insured, or negotiate or otherwise implement consensual terminations of insurance coverage prior to contractual maturity. While each situation is unique, various approaches may be used, including:

- Exercise of transaction rights and remedies, including enforcement
- Negotiation of amendments, waivers and consents
- Employment of advisors, consultants or internal auditors
- Restructuring or refinancing
- Repurchase of affected securities at a discount
- Litigation

### *Reinsurance*

The Company benefits from significant levels of reinsurance protections with AGL Group affiliated reinsurers, including its parent company AGM. Details of reinsurance contracts with affiliated reinsurers are provided in *Section E.1.a.*

Historically, the Company entered into reinsurance contracts with both affiliated and unaffiliated reinsurers in order to support its capital position and reduce the net potential loss from large risks. By virtue of several commutations completed by the Company since the 2008 financial crisis, as well as acquisitions of formerly unaffiliated reinsurers, the Company, as at 31 December 2018, had outstanding reinsurance with only one unaffiliated reinsurer.

The table below sets out the mitigation of the Company's gross par exposures provided by reinsurance.

**Ceded Par Outstanding to Reinsurers**

| **As at 31 December** | **2018** | **2017** |
|---|---|---|
| **Reinsurer** | **(in thousands)** | |
| Affiliated reinsurers | £ 13,582,921 | £ 13,125,603 |
| Unaffiliated reinsurers | 16,492 | 425,868 |
| Total reinsurance | £ 13,599,413 | £ 13,551,471 |

In 2018, the Company entered into a commutation agreement to reassume the entire portfolio previously ceded to one of its unaffiliated reinsurers. The size of the portfolio reassumed by the Company was approximately £401.0 million of par. The Company also entered into a commutation agreement to reassume the entire portfolio previously ceded to one of its affiliated reinsurers, reassuming approximately £7.5 million of par. For such reassumptions, the Company received the US statutory unearned premium and loss and loss adjustment expense reserves outstanding as at the commutation date, plus a commutation premium.

The Company remains primarily liable for all risks it underwrites directly and is required to pay all gross claims. The Company then seeks reimbursement from each reinsurer for its proportionate share of claims. Therefore, the use of reinsurance creates credit risk related to the reinsurers. The Company monitors the financial condition of each of its reinsurers on an ongoing basis, with a formal review of their creditworthiness presented to the ROC and Board quarterly. Internally assigned credit ratings are reviewed at least annually, and more often as dictated by the occurrence of outside events. The Company utilises detailed information received on a quarterly basis to monitor the financial condition, claims paying resources, solvency position and other events impacting the level of credit risk associated with these reinsurance relationships.

Furthermore, all reinsurers, including affiliated reinsurers, are required to post collateral to support their payment obligations. With the benefit of that collateral, the Company is able to substantially reduce its exposure to reinsurer counterparty risk, and to increase the effectiveness of its reinsurance arrangements as a loss mitigation tool. The Company has not experienced defaults by any of its reinsurers.

The Company is able to monitor the effectiveness of its reinsurance arrangements as a risk mitigation tool on an ongoing basis because reinsurance is incorporated directly into its ECM. Each risk is modelled with its associated reinsurance benefits, and is subject to losses only if there is a default of both the underlying risk and of the related reinsurer(s). The Company's quarterly ORSA reports include the ICA, both gross and net of reinsurance.

## Risk Sensitivity

At least annually, when the Company runs its ICA model, it runs a series of stress tests to determine the sensitivity of its ICA to various material risks, such as increases in the key variables used to calculate lifetime losses (probability of default, loss given default and correlation), and to credit events, such as the potential downgrade of AGM or AGC, the largest reinsurance exposure.

The Company also performs stress tests on its SCR by varying several of the parameters that are used to calculate the non-life underwriting risk and counterparty credit risk. Because the Company considers underwriting risk and reinsurance counterparty credit risk as its most material risks due to amounts of ceded par, it performs stress testing that increases the loss severity assumption used in Standard Formula from 10% to 20% for the two largest risks. No benefit was assumed for future management actions which could potentially mitigate future losses.

As at 31 December 2018, a 10% increase in the loss severity used to calculate the loss associated with the default of the largest two exposures (from 10% to 20%), would increase the non-life underwriting risk by £233.2 million to £498.5 million. The SCR would increase by £227.8 million to £529.1 million. This would cause the SCR Ratio to decline by 99 percentage points to 131%.

# C.2 MARKET RISK

Market risk includes the Company's exposure to interest rate and spread risk, market risk concentrations and foreign exchange risk. The Company's exposure to market risk is predominantly in respect of the Company's investment portfolio. The Company does not hold any equity investments and is not exposed to equity price risk. The size of the Company's investment portfolio, and as such its exposure to market risk, has increased significantly during the year as a result of the Merger.

The investment portfolio is managed by third party investment managers, with the exception of the portion of its investment portfolio invested in bonds held for loss mitigation purposes. Specific investment guidelines, which set forth credit rating standards, single risk and asset category limits and duration guidelines to mitigate market risk, are agreed with the investment managers and approved by the Company's Board, consistent with the ‘prudent person principle’ set out in the Solvency II Regulation.

One of the primary objectives in managing the investment portfolio is to support the highest possible rating for the Company. The overall portfolio credit quality (excluding the loss mitigation bonds in the internally managed portfolio) on an ongoing basis must be rated a minimum of "AA-"/"Aa3"/"AA-" as measured by S&P, Moody’s and Fitch. A minimum of 70% of the portfolio must be invested in securities rated at least in the “AA” category by two of S&P, Moody’s and Fitch. All securities purchased by external managers must be rated by one of S&P, Moody’s or Fitch and at least 95% of the portfolio must be rated by two of S&P, Moody’s and Fitch.

## Measurement

## Spread Risk

The Company is exposed to spread risk on its investment portfolio. The following table shows the Company's investment portfolios (excluding cash) by external credit rating as at 31 December 2018 and 2017.

**Investment Portfolio (Excluding Cash)**

| **As at 31 December** | | **2018** | | **2017** |
|---|---|---|---|---|
| | | **(in thousands)** | | |
| AAA | £ | 210,676 | £ | 23,399 |
| AA | | 347,775 | | 133,287 |
| A | | 111,751 | | 23,379 |
| BBB | | 43,320 | | 8,208 |
| <BBB or not rated | | 46,075 | | — |
| Total | **£** | **759,597** | **£** | **188,273** |

## Interest Rate Risk

The Company is exposed to interest rate risk in respect of both assets and liabilities. The Company receives cash inflows in the form of investment income, instalment premiums receivable, ceding commissions receivable and salvage recoverable. The Company pays cash outflows in the form of expenses, claims, loss adjustment expenses, ceded instalment premiums payable and excess of loss payments. Due primarily to the Company's large investment portfolio and the generally strong ratings of the Companies' financial guarantees, cash inflows are expected to materially exceed the Company's cash outflows.

The Company regularly reviews the duration of assets and liabilities.

## Currency Risk

The Company is exposed to currency risk in respect of both assets and liabilities under financial guarantees denominated in currencies other than GBP, as well as investments held in non-GBP currencies. The Company's exposure to the US dollar has increased during the year due to completion of the Merger and the transfer to the Company of a significant US dollar investment portfolio previously held by AGLN and AGUK.

The following table shows the Company's Assets and Liabilities by currency on a Solvency II basis as at 31 December 2018

**Solvency II balance sheet by currency**
**As at 31 December 2018**

| | GBP | EUR | USD (in thousands) | Other | Total |
|---|---|---|---|---|---|
| Assets | | | | | |
| Investments | £ 621,288 | £ — | £ 156,467 | £ — | £ 777,755 |
| Cash and cash equivalents | 32,577 | 2,621 | 2,489 | 95 | 37,782 |
| Reinsurance recoverables | (44,926) | 19,478 | (34,689) | 9,058 | (51,079) |
| Other assets | 22,149 | 632 | 8,421 | — | 31,202 |
| Total assets | £ 631,088 | £ 22,731 | £ 132,688 | £ 9,153 | £ 795,660 |
| Liabilities | | | | | |
| Technical provisions | £ 48,109 | £ (7,442) | £ 34,039 | £ 9,932 | £ 84,638 |
| Deposits from reinsurers and insurance, intermediaries and reinsurance payables | — | — | 5,574 | — | 5,574 |
| Any other liabilities | 3,038 | 335 | 9,538 | — | 12,911 |
| Total liabilities | £ 51,147 | £ (7,107) | £ 49,151 | £ 9,932 | £ 103,123 |

## Risk Concentration

As at 31 December 2018, the Company's investment portfolio had an average credit quality rating of "AA-". Issuer constraints as well as sector limitations are also followed in managing the investment portfolio. The table below sets forth the portfolio concentrations by instrument type.

**Composition of Investment Portfolio by Security Type**

| As at 31 December | 2018 | 2017 |
|---|---|---|
| UK Government bonds | 29% | 19% |
| Government guaranteed | 31% | 3% |
| Corporate bonds | 20% | 7% |
| US Government bonds | 7% | — |
| Asset and mortgage backed | 6% | — |
| Covered bonds | 4% | 2% |
| Short-term | 1% | 3% |
| Collective Investment Undertakings | 2% | — |
| Investments in Subsidiaries | — | 66% |
| Total | 100% | 100% |

## Risk Mitigation

The Company's exposure to market risk is managed in line with risk limit set out in the Company's Risk Appetite Statement and is actively monitored as part of the Company's ORSA process.

To mitigate spread risk, in the event of any downgrade of any investment below the Company's requirements, the portfolio manager must contact the Company's CFO or Treasurer to discuss the course of action and may hold the position only if approved by the CFO or Treasurer, and the Company's CEO. The Company has the ability to mitigate interest rate risk by changing its investment mix.

In order to mitigate currency risk arising from insurance liabilities, the Company will, from time to time, maintain assets denominated in those currencies.

## Risk Sensitivity

The most material risk in the investment portfolios is interest rate risk on fixed rate investments. Each quarter, as part of the Company's ORSA, the external investment managers provide the results of sensitivity to stress testing of the investment portfolio to interest rate movements. The scenario below assumes a 200% parallel upwards shift in the yield curve across all maturities. No benefit is assumed for future management actions which could potentially mitigate losses.

**Sensitivity analysis**

| As at 31 December | Upward Shift in Yield Curve | Increase/ (Decrease) in Value of Investment Portfolio | Interest Rate Risk included in Standard Formula Calculation of the SCR | Increase of the SCR in this Scenario | Decrease of SCR Ratio |
|---|---|---|---|---|---|
| | | | (in thousands) | | (in percentage points) |
| 2018 | 200 bps | £ (44,622) | £ 32,939 | £ 4,288 | 18 |
| 2017 | 200 bps | £ (13,296) | £ 7,669 | £ 931 | 5 |

An increase in the yield curve by 200 bps would have less than a 13% impact on the Company's solvency surplus as at 31 December 2018.

## C.3 CREDIT RISK

The Company's most significant credit risks are the risk of non-payment by the obligors on the transactions that it insures, and the counterparty risk to the reinsurers that assume a substantial portion of the Company's, outstanding exposures. These credit risks were addressed above in *Section C.1*. The only other counterparty credit risk the Company has relates to cash that the Company has on deposit with banks.

The following table shows cash and cash equivalents in the Solvency II balance sheet as at 31 December 2018 and 2017. The credit risk arising from these deposits is not material to the Company. The table excludes money market funds.

**Cash and cash equivalents (Solvency II balance sheet)**

| As at December | 2018 | 2017 |
|---|---|---|
| | (in thousands) | |
| Total | £ 37,781 | £ 13,600 |

## C.4 LIQUIDITY RISK

Liquidity risk is the risk that cash may not be available at a reasonable cost to pay obligations as they fall due. The Company manages its liquidity risk by maintaining a liquid, high quality investment portfolio, with a duration that is shorter than the duration of its insurance liabilities. Additionally, the Company is only required to pay principal and interest claims as they come due according to the original bond payment schedule, and the payments cannot be accelerated without the Company's consent.

## Measurement

The table below sets out the financial assets and liabilities, as measured under UK GAAP, by maturity date.

**UK GAAP Assets and liabilities by maturity date**

| As at 31 December 2018 | < 1 year or no contracted | 1 to 4 years | 5 to 10 years | 10 + years | Total |
|---|---|---|---|---|---|
| | | | (in thousands) | | |
| Assets | | | | | |
| Investments | £ 196,228 | £ 360,197 | £ 151,010 | £ 52,162 | £ 759,597 |
| Cash at bank | 48,387 | — | — | — | 48,387 |
| Debtors arising out of direct insurance operations | 69,470 | 137,703 | 129,965 | 147,652 | 484,790 |
| Debtors arising out of reinsurance operations | 11,517 | 17,536 | 17,442 | 24,986 | 71,481 |
| | £ 325,602 | £ 515,436 | £ 298,417 | £ 224,800 | £1,364,255 |
| Liabilities | | | | | |
| Creditors arising out of reinsurance operations | £ 56,941 | £ 57,475 | £ 57,424 | £ 82,360 | £ 254,200 |
| **As at 31 December 2017** | | | | | |
| Assets | | | | | |
| Investments | £ 15,539 | £ 119,074 | £ 51,153 | £ 2,506 | £ 188,272 |
| Cash at bank | 32,101 | — | — | — | 32,101 |
| Debtors arising out of direct insurance operations | 19,799 | 55,672 | 56,993 | 95,422 | 227,886 |
| Debtors arising out of reinsurance operations | 5,614 | 15,628 | 15,896 | 25,895 | 63,033 |
| | £ 73,053 | £ 190,374 | £ 124,042 | £ 123,823 | £ 511,292 |
| Liabilities | | | | | |
| Creditors arising out of reinsurance operations | £ 18,407 | £ 52,854 | £ 53,953 | £ 88,038 | £ 213,252 |

## Expected future profit included in future premiums

In respect of premiums receivable, the Company estimates that it has £212.3 million of expected future profits, which are not immediately available to meet liquidity needs since they have not yet been paid to the Company.

## Risk Concentration

The Company does not expect to have large cash outflows relative to the size of its investment portfolio or its annual investment income. Each quarter, the Company projects its upcoming liquidity requirements under a base case and a stress case. The Company maintains a significant liquidity buffer over both scenarios.

## Risk Mitigation

The Company could liquidate portions of its investment portfolio to meet any unexpected liquidity needs. The Company's investment portfolio is composed mainly of high rated and liquid investments.

## Risk Sensitivity

Each quarter, as part of its ORSA, the Company performs liquidity stress testing to ensure that it has sufficient liquid assets over the next 12 month period to cover all of its liabilities that could arise in a stress scenario. When the Company performs the stress test, it considers only government bonds, money markets and cash to be liquid assets.

# C.5 OPERATIONAL RISK

The Company faces a variety of operational risks including those related to information technology, accounting, legal and regulatory matters, as well as risks related to performance by affiliated companies pursuant to a services agreement and third party service providers. As at 31 December 2018, the Company had only 146 credit risks in its insured portfolio and generally adds only a small number of new transactions each year, limiting potential operational errors. The relatively small number of risks allows careful review of the transaction documents and quality control of the data points captured in the Company's systems by knowledgeable employees.

Operational risks are further limited by the Company's risk management policies, such as the policies governing the credit approval process, compliance, data protection, business continuity planning, and employee conduct. Additional mitigants to operational risk include that its service agreements are with stable affiliated companies, and the system of internal controls in place, which are described in *Section B.4*

With regard to legal risk, as at 31 December 2018 the Company was not involved in any ongoing litigation.

## C.6 OTHER MATERIAL RISKS

### Brexit

A principal uncertainty for the Company arising from the UK's planned exit from the EU is whether it will continue to be able to utilise passporting rights to conduct insurance activities within EEA countries after Brexit. In order to ensure that existing EEA based insurance policies can continue to be serviced and new EEA transactions can be entered into, in the event that passporting rights are not retained, the Company along with AGM is in the process of establishing a new company in France from which these activities will be conducted. If the Company's ability to service existing policies is not preserved, these policies will be transferred to the new company. In the case that the transfer of policies is not completed prior to the UK's departure, including where the UK leaves the EU without agreement on the terms of its exit (a "no deal Brexit"), it is management's belief that the risks posed to the Company will be significantly mitigated by measures recently announced by a number of EU countries which provide transitional arrangements for the servicing of existing policies.

## C.7 ANY OTHER INFORMATION

None.

# D. VALUATION FOR SOLVENCY PURPOSES

This section sets out the valuation of assets, Technical Provisions and other liabilities of the Company under Solvency II, as well as details of the valuation methodology and the differences to valuation under UK GAAP, as reported within the Company's financial statements.

## D.1 ASSETS

The table below sets out the valuation of assets as reported in the Company's UK GAAP financial statements and the Solvency II balance sheet as at 31 December 2018.

**Assets**
**As at 31 December 2018**

| | Financial Statement Balance Sheet | Solvency II Balance Sheet |
|---|---|---|
| | (in thousands) | |
| Deferred acquisition costs | £ 29,784 | £ — |
| Deferred tax assets | 1,118 | 17,376 |
| Investments | 759,597 | 777,755 |
| Property, plant & equipment held for own use | 707 | — |
| Reinsurance recoverables: | | |
| Reinsurer's share of provision for unearned premiums | 433,178 | — |
| Reinsurer's share of claims outstanding | 24,607 | — |
| Reinsurer's share of other technical provisions (unexpected risk provisions) | 12,711 | — |
| Reinsurer's share of technical provisions (premium provision and claims provision) | — | (51,080) |
| Total reinsurance recoverables | 470,496 | (51,080) |
| Insurance and intermediaries receivables: | | |
| Current premiums receivable | 8,036 | 8,036 |
| Future premiums receivable | 476,754 | — |
| Total insurance and intermediaries receivables | 484,790 | 8,036 |
| Reinsurance receivables: | | |
| Current reinsurance commissions receivable | 2,229 | 2,229 |
| Future reinsurance commissions receivable | 69,252 | — |
| Total reinsurance receivables | 71,481 | 2,229 |
| Receivables (trade, not insurance) | 3,530 | 3,530 |
| Cash and cash equivalents | 48,387 | 37,781 |
| Other assets | 7,585 | 33 |
| Total assets | £ 1,877,475 | £ 795,660 |

Set out below is a summary of the valuation methodology used to arrive at the value of each category of assets shown on the balance sheet for Solvency II purposes and the differences to UK GAAP.

## Deferred Acquisition Costs

Deferred acquisition costs are fully eliminated in the Solvency II balance sheet and future operating expenses are incorporated within Technical Provisions which are liabilities on the Solvency II balance sheet. Under UK GAAP, acquisition costs incurred, which represent a portion of expenses related to the production of business, are deferred and amortised over the period in which the related premiums are earned.

## Deferred Tax Assets

The method for recognition and valuation of deferred tax assets is the same under Solvency II and UK GAAP. Within the Solvency II balance sheet deferred tax assets are established for the temporary differences arising from the valuation adjustments to move from UK GAAP to Solvency II. Deferred tax is measured using tax rates that have been enacted or substantively enacted by the year end and that are expected to apply to the reversal of the timing difference. Deferred tax assets are recognised only to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

## Investments

Investments are measured on a fair value basis under both UK GAAP and Solvency II. Fair value is based on quoted market prices, where available. If listed prices or quotes are not available, fair value is based on either internally developed models that primarily use, as inputs, market-based or independently sourced market parameters, including but not limited to yield curves, interest rates and debt prices or third party proprietary pricing models.

The fair value of bonds in the investment portfolio is generally based on prices received from third party pricing services or alternative pricing sources with reasonable levels of price transparency. The pricing services prepare estimates of fair value measurements using their pricing models, which take into account: benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers, reference data, industry and economic events and sector groupings. The Company considers markets to be active where transactions take place with sufficient frequency and volume for pricing information to be available on an ongoing basis.

Where the Company has concluded that markets are not active i.e. investment assets which cannot be priced using quoted market prices or using observable market-based prices or other inputs (that is, for which market data is unavailable) are valued under a discounted cash flow approach using an independent third-party's proprietary pricing models. The models use inputs such as projected prepayment speeds; severity assumptions; recovery lag assumptions; life insurance cash flow projections; estimated default rates (determined on the basis of an analysis of collateral attributes, historical collateral performance; collateral reinvestment assumptions; borrower profiles and other features relevant to the evaluation of collateral credit quality); and recent trading activity. The yield used to discount the projected cash flows is determined by reviewing various attributes of the security including collateral type, weighted average life, sensitivity to losses, vintage, and convexity, in conjunction with market data on comparable securities. Significant changes to any of these inputs could have materially changed the expected timing of cash flows within these securities which is a significant factor in determining the fair value of the securities. As at 31 December 2018 these comprised 5.9 % of the investment portfolio.

## Reinsurance Recoverables

Reinsurance recoverables recognised for Solvency II purposes consist of the reinsurers' share of Technical Provisions. The reinsurance recoverables reported within the financial statements comprise of reinsurers' share of provisions for unearned premiums, claims outstanding and other technical provisions (i.e., unexpired risk provisions).

The valuation methodologies for Technical Provisions under Solvency II and UK GAAP are discussed in *Section D.2*

## Insurance and Intermediaries Receivables

Insurance and intermediaries receivables recognised for Solvency II purposes consist of premiums that were past due at the balance sheet date. Insurance and intermediaries receivables reported under UK GAAP consist of all premiums that were receivable at the balance sheet date, including those past due, and future premiums receivable. Additionally, under UK GAAP, insurance receivables also include salvage receivable in respect of claims paid. For Solvency II purposes expected cash flow from salvage are included in Technical Provisions.

## Reinsurance Receivables

Reinsurance receivables in the Solvency II balance sheet consist of reinsurance commissions that were past due at the balance sheet date. Reinsurance commission receivables reported under UK GAAP consist of both reinsurance commissions that were receivable at the balance sheet date, including those past due, and future reinsurance commissions receivable on an undiscounted basis.

## Receivables (Trade, not Insurance)

These relate to other debtors that were due at the balance sheet date. Given the short-term nature, the expected settlement amount is taken to approximate fair value.

## Cash and Cash Equivalents

Cash relates to deposits held at financial institutions. These are recognised at face value without any deductions for both UK GAAP and Solvency II purposes. Under Solvency II, certain deposits are reported as collective investment undertakings and included within the value of financial investments. Under UK GAAP these deposits are included within cash and cash equivalent.

## Any Other Assets, not Elsewhere Shown

Under UK GAAP, other assets include accrued interest due at the balance sheet date and prepaid expenses. Under Solvency II, accrued interest is included within the value of financial investments.

## D.2 TECHNICAL PROVISIONS

The table below presents a comparison of UK GAAP gross insurance liabilities and Solvency II Technical Provisions.

**Technical Provisions**
**As at 31 December 2018**

| | Financial Statement Balance Sheet | Solvency II Balance Sheet |
|---|---|---|
| | (in thousands) | |
| Best Estimate | £ — | £ (126,335) |
| Risk margin | — | 210,974 |
| Provision for unearned premiums | 665,701 | — |
| Claims outstanding | 27,341 | — |
| Unexpired risk provisions | 16,285 | — |
| Total | £ 709,327 | £ 84,639 |

**a. Valuation bases, methods and main assumptions**

The best estimate component of Technical Provisions represent the present value of future cash outflows less the present value of future cash inflows. The present value of cash inflows and outflows includes the following:

- expected lifetime loss,
- a provision for all future run-off costs,
- all future premiums after consideration of potential non-payment on premiums due to future defaults of guaranteed transactions,
- all future ceding commissions and
- salvage receivable related to historic paid claims expected to be recovered.

The Company's expected lifetime losses under Solvency II are calculated using the Company's ECM which uses assumptions for cumulative probability of default, loss given default and correlation to calculate the gross expected cash outflows that the Company will be required to pay over the lifetime of the insured exposures. The Company considers both external and internal sources of data when setting assumptions for probability of default, loss given default and correlation, including any relevant experience by companies within AGL Group. The boundary of each insurance contract is assumed to be the period of time during which the principal on the debt underlying the financial guarantee contract is greater than £nil. The Company uses expert judgement to assess future inflation rates for guarantees that are linked to an inflation index.

For purposes of the best estimate loss component of Technical Provisions, the provision for future run-off expense is projected based on the Company's current operating costs taking into consideration activities required to service the existing insured portfolio.

The percentage of premiums expected not to be received due to potential defaults was developed by applying expected default rates to the future premiums.

The risk margin is an estimate of the amount that a third party would expect to receive in addition to the best estimate liability to assume the Company's insurance obligations. The risk margin is calculated as the present value of the cost of capital (i.e cost of holding capital equal to SCR) in all future years as the insured exposure runs off. The Company estimates the SCR in all future years based on the reduction in insured GPO. The cost of capital to be used in the calculation is prescribed by EIOPA at 6% per annum.

During the year there were two material changes to assumptions used to calculate the technical provisions. The assumptions for future run-off expenses were revised as a result of the Merger to reflect expected synergies or cost savings. In addition, the expected loss assumptions for the Company's guaranteed sovereign and sub sovereign exposures were revised based on additional historical data.

**b. Uncertainty**

While the Company believes that the assumptions and methods used to develop the Technical Provisions are reasonable and consistent and that they provide for a calculation of expected outcomes in an appropriate manner, it remains possible future experience may differ from expectation. The level of uncertainty in relation to the calculation of expected losses is high as the Company guarantees against low probability events with high value exposures. Some of this uncertainty is mitigated by the Company's reinsurance protections (58% of the Company's total gross exposure is fully reinsured as at 31 December 2018). The level of uncertainty in respect of future premiums, future ceding commission and projected operating expenses is expected to be low because, in most cases cash inflows are contractually guaranteed and the annual operating expenses that would be required to manage the runoff of the portfolio can be reasonably estimated based on current staffing levels. The Company does not include any benefits related to future management actions and it is unlikely that policyholder behaviour would affect the Technical Provisions.

**c. Material differences between Solvency II and UK GAAP for valuation of Technical Provisions**

The following is a summary of the material differences between Solvency II and UK GAAP Technical Provisions:

- Premiums scheduled to be received or ceded premium scheduled to be paid, less the expected amounts not to be paid due to defaults, are required to be discounted by the Solvency II Regulations. Under UK GAAP these values are undiscounted at the balance sheet date;
- Projected future claims under Solvency II are significantly higher than under UK GAAP because an expected loss value is ascribed to every exposure guaranteed by the Company instead of just exposures where the likelihood of loss is probable. Furthermore, the discount rates ascribed by EIOPA, which are based on risk-free rates, are typically lower than the discount rates used by the Company to discount claims liabilities under UK GAAP which are based on the expected yield to maturity of the investment portfolio;
- A deduction for expected losses on the reinsurer's share of future claims due to future reinsurance counterparty defaults is required under Solvency II, however UK GAAP only requires a provision to be established where the default of a reinsurance counterparty is likely;
- A provision for all future run-off costs of the insured portfolio is required under Solvency II, however UK GAAP only requires such provisions for claims incurred and;
- Solvency II Technical Provisions include a risk margin.

## Matching Adjustment

The matching adjustment referred to in Article 77(b) of the Directive is not used in the calculation of Technical Provisions.

## Volatility Adjustment

The volatility adjustment referred to in Article 77(d) of the Directive is not used in the calculation of Technical Provisions.

## Transitional Risk Free Interest Rate Term Structure

The transitional risk free interest rate term structure referred to in Article 308(c) of the Directive is not used in the calculation of Technical Provisions.

## Transitional Deduction

The transitional deduction referred to in Article 308(d) of the Directive is not used in any calculations.

## Recoverables From Reinsurance and Special Purpose Vehicles

The Company reinsures 58% of its gross exposure to affiliated and non-affiliated reinsurers. Under Solvency II, reinsurance recoverables represent the contractually obligated payments, less a component for the expected losses in the event that reinsurers are unable to make their share of these payments in excess of the amount of collateral provided by the Company. This component is calculated based on the projected ceded expected losses to each reinsurer, the assumed cumulative default rate of each reinsurer and the amount of collateral posted by each reinsurer. Under UK GAAP the Company does not include a provision for reinsurance counterparty default unless such a scenario, in which the reinsurer fails to pay, becomes probable.

There are no special purpose vehicle recoverables included in any of the calculations of Technical Provisions or risk margin.

## D.3 VALUATION OF OTHER LIABILITIES

The table below presents a comparison of liabilities under UK GAAP and Solvency II.

**Liabilities**
**As at 31 December 2018**

| | Financial Statement Balance Sheet | Solvency II Balance Sheet |
|---|---|---|
| | (in thousands) | |
| Reinsurance payables: | | |
| Current reinsurance premiums payable | £ 5,574 | £ 5,574 |
| Future reinsurance premiums payable | 248,626 | — |
| Salvage payable | | |
| Total reinsurance payables | 254,200 | 5,574 |
| Payables (trade, not insurance) | 11,883 | 11,883 |
| Other liabilities: | | |
| Reinsurance commissions deferred | 130,055 | — |
| Other liabilities (including accrued expenses) | 1,027 | 1,027 |
| Total other liabilities | 131,082 | 1,027 |
| Total liabilities excluding technical provisions | 397,165 | 18,484 |
| Best estimate | — | (126,335) |
| Risk margin | — | 210,974 |
| Technical provisions | 709,327 | 84,639 |
| Total liabilities | £ 1,106,492 | £ 103,123 |

The following is a description of the valuation methodology used to arrive at the value of each category of liabilities shown on the balance sheet for Solvency II purposes and the differences to UK GAAP. There were no changes made to the recognition and valuation bases used or to estimations during the period.

### Reinsurance Payables

Reinsurance payables recognised for Solvency II purposes consist of reinsurance premiums that were payable at the balance sheet date. Reinsurance premiums payable reported under UK GAAP consist of both reinsurance premiums that were payable at the balance sheet date and future reinsurance premiums payable on an undiscounted basis. Additionally, the UK GAAP value includes reinsurer's share of salvage receivable related to historic paid claims. For Solvency II purposes these amounts are included in Technical Provisions.

### Payables (Trade, not Insurance)

Trade payables relate to amounts owed to other creditors, including amounts owed to affiliated companies. Payables are valued at the expected settlement amount, which given the short-term nature, is taken to approximate fair value.

### Any Other Liabilities, not Elsewhere Shown

Any other liabilities not shown elsewhere recognised for Solvency II purposes consist of accrued expenses that have not been settled at the balance sheet date. UK GAAP balances additionally include deferred reinsurance commissions at the balance sheet date. Under Solvency II the reinsurance commissions are incorporated within Technical Provisions. Accrued expenses are valued at cost, on the proportion of goods and services that have been consumed.

## D.4 ALTERNATIVE METHODS OF VALUATION

Article 296 of the Solvency II Regulation lays out several requirements that must be disclosed publicly with regard to the valuation of assets and liabilities. These requirements are covered in *Section D.1*, *Section D.2 and Section D.3.*

All the Company's investments are either:

- cash equivalents that are categorised as level 1 (quoted market prices in active markets),
- repurchased insured loss mitigation securities that are categorised level 3 (alternative valuation methods), or
- other financial investments are categorised as level 2 (quoted market prices in active markets for similar assets),

## D.5 ANY OTHER INFORMATION

There is no other material information on valuation for Solvency II purposes.

# E. CAPITAL MANAGEMENT

This section sets out how the Company manages its Own Funds, including policies and procedures for the management of capital, as well as the amount of the Company's SCR and MCR.

## E.1 OWN FUNDS

### a. Objectives, policies and processes of managing Own Funds

A primary objective of the Company's capital management policy is to ensure sufficient capital resources to meet both the Company's regulatory capital requirements as well as the Company's own economic capital assessment, the ICA.

The Company prepares a business plan with a one year time horizon on an annual basis. The business planning process takes into account both regulatory and economic capital requirements. The business plan considers the sufficiency of the Company's capital surplus under the ICA and Solvency II SCR.

The Company has affiliate reinsurance and other support agreements in place, which are important to the management of capital and Own Funds. Details of these agreements are included below.

AGM currently provides support to the Company, through the AGM Reinsurance Agreement and the AGM NWM Agreement. The versions of such agreements currently in force became effective on 7 November 2018 upon completion of the Merger.

These new agreements clarified the application of the prior agreements to the Company upon the Merger. They also incorporated changes to certain terms, including a change to the amount of collateral that AGM is obligated to post as security for its reinsurance of the Company. Except for such changes, the new agreements do not materially alter the terms or coverage of the prior agreements.

Under the quota share cover of the AGM Reinsurance Agreement, AGM reinsures between approximately 95% - 99% of the Company's retention of each financial guarantee insurance policy after cessions to other reinsurers, excluding the transactions transferred to the Company under the Merger. The policies reinsured under the agreement were those issued prior to 2011 because the Company has underwritten new business on a coinsurance basis from 2011. The agreement also provides that to the extent AGE issues a future qualifying policy without utilising the co-guarantee structure described above, AGM will reinsure a fixed 85% share of the Company's gross liabilities under such policy.

Under the excess of loss cover of the AGM Reinsurance Agreement, AGM pays the Company quarterly the amount by which (i) the sum of (a) the Company's incurred losses calculated in accordance with UK GAAP and (b) the Company's paid losses and loss adjustment expenses, in both cases net of all other performing reinsurance, including the reinsurance provided by the Company under the quota share cover of the AGM Reinsurance Agreement, exceeds (ii) an amount equal to (a) the Company's capital resources under UK law minus (b) 110% of the greatest of the amounts as may be required by the PRA as a condition for the Company to maintain its authorisation to carry on a financial guarantee business in the UK. The AGM Reinsurance Agreement permits the Company to terminate the agreement upon the following events: a downgrade of AGM's ratings by Moody's below Aa3 or by S&P below AA- if AGM fails to restore its rating(s) to the required level within a prescribed period of time; AGM's insolvency or failure by AGM to maintain the minimum capital required by its home jurisdiction. The quota share and excess of loss covers each exclude transactions guaranteed by the Company on or after 1 July 2009 that are not municipal, utility, project finance or infrastructure risks or similar types of risks.

The AGM Reinsurance Agreement requires AGM to pledge collateral to support AGM's reinsurance obligations to the Company. The terms of the collateral requirement were changed during the year on entry into the revised AGM Reinsurance Agreement dated 7 November 2018. Under the revised agreement, AGM's collateral requirement at the end of each calendar quarter is calculated as the sum of: (a) AGE's unearned premium reserve (net of AGE's reinsurance premium payable to AGM); (b) AGE's provisions for unpaid losses and allocated loss adjustment expenses (net of any salvage recoverable), and (c) any unexpired risk provisions of AGE, in each case as calculated by the Company in accordance with UK GAAP. As a result of this new collateral measure, AGM's total collateral pledged to AGE increased by approximately £40.0 million at the date of entry into the agreement.

Under the terms of the AGM NWM Agreement, AGM is obligated to cause the Company to maintain capital resources equal to 110% of the greatest of the amounts as may be required by the PRA as a condition for the Company to maintain its authorisation to carry on financial guarantee business in the UK provided that AGM's contributions (a) do not exceed 35% of AGM's policyholders' surplus on an accumulated basis as determined by the laws of the State of New York, and (b) are in compliance with Section 1505 of the New York Insurance Law. AGM has never been required to make any contributions to the Company's capital under the NWM Agreement.

At the date of the Merger, the Company also entered into the AGC Reinsurance Agreement. This new agreement preserves AGC's 90% quota share reinsurance of the legacy AGUK policies and 100% reinsurance of the legacy CIFGE policies that are now part of the Company's portfolio, but it has no application to new business written by the Company. The AGC Reinsurance Agreement also imposes a new collateral requirement on AGC consistent with that for the AGM Reinsurance Agreement, as described above, except that AGC continues also to post as collateral its share of two AGE-guaranteed (formerly, prior to the Merger, AGUK-guaranteed) triple-X insurance bonds that have been purchased by AGC for loss mitigation, as AGC had similarly done under its prior reinsurance agreement with AGUK.

## b. Structure, amount and quality of Own Funds

The capital structure of the Company consists of Basic Own Funds only. The amount of Own Funds has increased during the year, due to: (i) a reduction in the level of risk margin as at 31 December 2018, compared to the sum of risk margin for the Company and it subsidiaries as at 31 December 2017, due to the Merger; (ii) the recognition of a deferred tax asset compared to a deferred tax liability at 31 December 2017, also due to the Merger and (iii) insured portfolio run-off.

As at 31 December 2018, Basic Own Funds comprised £55.0 million of allotted and fully paid ordinary shares and the reconciliation reserve of £620.2 million, both classified as Tier 1 capital. The Company does not have any restricted Tier 1 capital. Additionally the Company has Tier 3 capital of £17.4 million in the form of deferred tax assets.

## c. Eligibility of Own Funds to cover SCR

The value of eligible Own Funds to cover SCR is shown below:

| **As at 31 December** | | **2018** | | **2017** |
|---|---|---|---|---|
| | | **(in thousands)** | | |
| Tier 1 | £ | 675,161 | £ | 629,226 |
| Tier 2 | | — | | — |
| Tier 3 | | 17,376 | | — |
| Total | £ | 692,537 | £ | 629,226 |

The quantitative limits on items eligible to cover the SCR do not result in any deductions from Own Funds.

## d. Eligibility of Own Funds to cover MCR

The Company's Tier 3 Own Funds are not eligible to cover the MCR, as such total Own Funds available to cover the MCR as at 31 December 2018 were £675.2 million (2017: £629.2 million).

## e. Differences between shareholders equity and excess of assets over liabilities

The differences between shareholders' equity under UK GAAP and excess of assets over liabilities under Solvency II are the reconciliation reserve and deferred tax assets. A detailed explanation of the differences in the valuation of assets and liabilities is provided in *Section D.1* and *Section D.3*. The following is a reconciliation between shareholder's equity under UK GAAP and excess of assets over liabilities under Solvency II.

**Reconciliation between Shareholder's Equity and excess of assets over liabilities**

| **As at 31 December** | | **2018** | | **2017** |
|---|---|---|---|---|
| | | **(in thousands)** | | |
| Shareholder's equity under UK GAAP | £ | 770,983 | £ | 553,836 |
| Reconciliation reserve: | | | | |
| *Adjustments to assets (see Section D.1)* | | (1,081,815) | | (656,483) |
| *Adjustments to liabilities (including technical provisions) (see Section D.3)* | | 1,003,369 | | 731,873 |
| Excess of assets over liabilities for Solvency II purposes | £ | 692,537 | £ | 629,226 |

## f. Basic Own Funds subject to transitional arrangements

There are no basic own fund items subject to transitional arrangements.

## g. Ancillary Own Funds

There are no ancillary Own Funds.

## h. Basic own funds deductions and significant restrictions

There are no items deducted from Own Funds and no significant restriction affecting the availability of Own Funds.

## E.2 SCR and MCR

## a. SCR and MCR

The Company’s SCR as at 31 December 2018 was £301.3 million (2017: £112.6 million). This is shown in *Section F S.25.01*. The Company’s MCR as at 31 December 2018 was £75.3 million (2017: £28.2 million). This is shown on the S*ection F S. 28.01.*

## b. Split of the SCR by risk module

The Company used the Standard Formula to calculate its SCR in 2018 and 2017.

The table below shows the Company's SCR split by risk module as at 31 December 2018 and 31 December 2017.

| **As at 31 December** | | **2018** | | **2017** |
|---|---|---|---|---|
| | | **(in thousands, except ratios)** | | |
| Underwriting risk | £ | 265,342 | £ | 10,843 |
| Market risk | | 87,442 | | 108,332 |
| Counterparty risk | | 1,394 | | 912 |
| Diversification benefit | | (54,035) | | (8,280) |
| Operational risk | | 1,189 | | 810 |
| SCR | £ | 301,332 | £ | 112,617 |
| SCR Ratio | | 2.30:1 | | 5.59:1 |
| MCR | £ | 75,333 | £ | 28,154 |
| MCR Ratio | | 8.96:1 | | 22.35:1 |

The SCR increased by £188.7 million during 2018, as a result of an increase of £254.5 million in underwriting risk, offset by a £20.9 million reduction in market risk and a £45.8 million increase in diversification benefit. These movements were largely the result of the Merger.

The underwriting risk requirement increased as a result of increases in NPO on the Company's two largest exposures which increased catastrophe risk by £227.8 million. The insured portfolio acquired from AGLN contains limited levels of reinsurance and greatly increased the Company's NPO. The market risk requirement also decreased due to the Merger. At 31 December 2018 market risk is calculated on the combined investment portfolio instead of applying a 22% equity risk charge to the Solvency II excess of assets over liabilities for AGUK, AGLN and CIFGE, as was required prior to the Merger when these companies were subsidiaries. The increased diversification benefit is driven from the increased underwriting risk discussed above.

## c. Use of simplified calculations

The Company follows the guidance prescribed by the Solvency II Regulation for the calculation of the Standard Formula and does not use any simplified calculations.

## d. Use of USPs

The Company does not use any USPs in its calculations of the Standard Formula.

### e. Disclosure of USPs and capital add-on

As at the end of the reporting period, the Company was not required to use any USPs or a capital add-on in its calculation of the SCR.

### f. Impact of USPs and capital add-on

Not applicable.

### g. Information on the inputs into MCR calculation

The inputs into the MCR calculation for 31 December 2018 and 31 December 2017 were:

| **As at 31 December** | | **2018** | | **2017** |
|---|---|---|---|---|
| **Inputs** | | **(in thousands)** | | |
| Net Technical Provisions | £ | (75,256) | £ | (17,363) |
| Net Technical Provisions (floor 0) | | — | | — |
| Net written premiums over 12-month reporting period | | (5,287) | | (53,096) |
| Net written premiums over 12-month reporting period (floor 0) | | — | | — |
| Linear MCR | | — | | — |
| SCR | £ | 301,332 | | 112,617 |
| MCR Cap | | 135,600 | | 50,678 |
| MCR Floor | | 75,333 | | 28,154 |
| Absolute Floor of the MCR | | 3,288 | | 3,307 |

### h. Material changes to the SCR and MCR over the reporting period

Upon completion of the Merger discussed in section A, both the SCR and MCR increased materially due to the increase in the Company's assets and liabilities and increase in the size of the insured portfolio.

## E.3 USE OF THE DURATION-BASED EQUITY RISK SUB-MODULE

The Company does not apply the duration-based equity risk sub-module.

## E.4 DIFFERENCES BETWEEN THE STANDARD FORMULA AND ANY INTERNAL MODELS USED

In 2018, the Company does not use an internal model to calculate its SCR. For more information see *Section E.2.*

## E.5 NON-COMPLIANCE WITH MCR AND SIGNIFICANT NON-COMPLIANCE WITH SCR

### a. The period and maximum amount of each non-compliance with MCR during the reporting period; explanation of origin, consequences and remedial measures taken

The Company did not have any period of non-compliance with the MCR during the reporting period.

### b. Amount of any ongoing non-compliance with the MCR as at the reporting date

The Company was in compliance with the MCR as at the reporting date.

### c. The period and maximum amount of each non-compliance with SCR during the reporting period; explanation of origin, consequences and remedial measures taken

The Company did not have any period of non-compliance with the SCR during the reporting period, or as at the reporting date.

### d. Amount of any significant non-compliance with the SCR at the reporting date

The Company was compliant with the SCR as at the reporting date.

## E.6 ANY OTHER INFORMATION

None.

# F. QUANTITATIVE REPORTING TEMPLATES

| QRT reference | QRT Template name |
|---|---|
| S.02.01.02 | Balance Sheet |
| S.05.01.02 | Premiums, claims and expenses by line of business |
| S.05.02.01 | Premiums, claims and expenses by country |
| S.17.01.02 | Non-Life Technical Provisions |
| S.19.01.21 | Non-life insurance claims |
| S.23.01.01 | Own Funds |
| S.25.01.21 | Solvency Capital Requirement - For undertakings on Standard Formula |
| S.28.01.01 | Minimum Capital Requirement - Only life or only non-life insurance or reinsurance activity |

## Balance Sheet
## S.02.01.02
## GBP £'000

**Assets**

| | | Solvency II value |
|---|---|---|
| | | **C0010** |
| Intangible assets | R0030 | |
| Deferred tax assets | R0040 | 17,376 |
| Pension benefit surplus | R0050 | |
| Property, plant & equipment held for own use | R0060 | |
| **Investments (other than assets held for index-linked and unit-linked contracts)** | **R0070** | **777,755** |
| Property (other than for own use) | R0080 | |
| Holdings in related undertakings, including participations | R0090 | |
| *Equities* | *R0100* | |
| Equities - listed | R0110 | |
| Equities - unlisted | R0120 | |
| *Bonds* | *R0130* | 767,149 |
| Government Bonds | R0140 | 515,048 |
| Corporate Bonds | R0150 | 202,426 |
| Structured notes | R0160 | |
| Collateralised securities | R0170 | 49,675 |
| Collective Investments Undertakings | R0180 | 10,605 |
| Derivatives | R0190 | |
| Deposits other than cash equivalents | R0200 | |
| Other investments | R0210 | |
| Assets held for index-linked and unit-linked contracts | R0220 | |
| **Loans and mortgages** | **R0230** | |
| Loans on policies | R0240 | |
| Loans and mortgages to individuals | R0250 | |
| Other loans and mortgages | R0260 | |
| **Reinsurance recoverables from:** | **R0270** | **(51,080)** |
| Non-life and health similar to non-life | R0280 | (51,080) |
| Non-life excluding health | R0290 | (51,080) |
| Health similar to non-life | R0300 | |
| Life and health similar to life, excluding health and index-linked and unit-linked | R0310 | |
| Health similar to life | R0320 | |
| Life excluding health and index-linked and unit-linked | R0330 | |
| Life index-linked and unit-linked | R0340 | |
| Deposits to cedants | R0350 | |
| Insurance and intermediaries receivables | R0360 | 8,036 |
| Reinsurance receivables | R0370 | 2,229 |
| Receivables (trade, not insurance) | R0380 | 3,530 |
| Own shares (held directly) | R0390 | |
| Amounts due in respect of own fund items or initial fund called up but not yet paid in | R0400 | |
| Cash and cash equivalents | R0410 | 37,781 |
| Any other assets, not elsewhere shown | R0420 | 33 |
| **Total assets** | **R0500** | **795,660** |

## Balance Sheet (continued)
## S.02.01.02
## GBP £'000

| | | Solvency II value |
|---|---|---|
| | | C0010 |
| **Liabilities** | | |
| **Technical provisions - non-life** | **R0510** | **84,639** |
| **Technical provisions - non-life (excluding health)** | **R0520** | **84,639** |
| TP calculated as a whole | R0530 | |
| Best estimate | R0540 | (126,335) |
| Risk margin | R0550 | 210,974 |
| **Technical provisions - health (similar to non-life)** | **R0560** | |
| TP calculated as a whole | R0570 | |
| Best estimate | R0580 | |
| Risk margin | R0590 | |
| **TP - life (excluding index-linked and unit-linked)** | **R0600** | |
| **Technical provisions - health (similar to life)** | **R0610** | |
| TP calculated as a whole | R0620 | |
| Best estimate | R0630 | |
| Risk margin | R0640 | |
| **TP - life (excluding health and index-linked and unit-linked)** | **R0650** | |
| TP calculated as a whole | R0660 | |
| Best estimate | R0670 | |
| Risk margin | R0680 | |
| **TP - index-linked and unit-linked** | **R0690** | |
| TP calculated as a whole | R0700 | |
| Best estimate | R0710 | |
| Risk margin | R0720 | |
| Contingent liabilities | R0740 | |
| Provisions other than technical provisions | R0750 | |
| Pension benefit obligations | R0760 | |
| Deposits from reinsurers | R0770 | |
| Deferred tax liabilities | R0780 | |
| Derivatives | R0790 | |
| Debts owed to credit institutions | R0800 | |
| Financial liabilities other than debts owed to credit institutions | R0810 | |
| Insurance & intermediaries payables | R0820 | |
| Reinsurance payables | R0830 | 5,574 |
| Payables (trade, not insurance) | R0840 | 11,883 |
| **Subordinated liabilities** | **R0850** | |
| Subordinated liabilities not in BOF | R0860 | |
| Subordinated liabilities in BOF | R0870 | |
| Any other liabilities, not elsewhere shown | R0880 | 1,027 |
| **Total liabilities** | **R0900** | **103,123** |

| | | |
|---|---|---|
| **Excess of assets over liabilities** | **R1000** | **692,537** |

**Premiums, claims and expenses by line of business**
**S.05.01.02**
**GBP £'000**

| | | Credit and suretyship insurance | Total |
|---|---|---|---|
| | | C0090 | C0200 |
| **Premiums written** | | | |
| Gross - Direct Business | R0110 | 5,823 | **5,823** |
| Gross - Proportional reinsurance accepted | R0120 | | |
| Gross - Non-proportional reinsurance accepted | R0130 | | |
| Reinsurers' share | R0140 | 8,593 | **8,593** |
| **Net** | **R0200** | **(2,770)** | **(2,770)** |
| **Premiums earned** | | | |
| Gross - Direct Business | R0210 | 36,011 | **36,011** |
| Gross - Proportional reinsurance accepted | R0220 | | |
| Gross - Non-proportional reinsurance accepted | R0230 | | |
| Reinsurers' share | R0240 | 43,605 | **43,605** |
| **Net** | **R0300** | **(7,594)** | **(7,594)** |
| **Claims incurred** | | | |
| Gross - Direct Business | R0310 | 9,350 | **9,350** |
| Gross - Proportional reinsurance accepted | R0320 | | |
| Gross - Non-proportional reinsurance accepted | R0330 | | |
| Reinsurers' share | R0340 | 8,445 | **8,445** |
| **Net** | **R0400** | **905** | **905** |
| **Changes in other technical provisions** | | | |
| Gross - Direct Business | R0410 | 7,146 | **7,146** |
| Gross - Proportional reinsurance accepted | R0420 | | |
| Gross - Non-proportional reinsurance accepted | R0430 | | |
| Reinsurers' share | R0440 | 4,373 | **4,373** |
| **Net** | **R0500** | **2,773** | **2,773** |
| **Expenses incurred** | **R0550** | **814** | **814** |
| **Other expenses** | R1200 | | |
| **Total expenses** | **R1300** | | **814** |

## Premiums, claims and expenses by country
## S.05.02.01
## GBP £'000

| | | Home Country | Top 5 countries (by amount of gross premiums written) - non-life obligations | Total Top 5 and home country |
|---|---|---|---|---|
| | | C0010 | C0020 | C0070 |
| | R0010 | GB | FR | |
| | | C0080 | C0090 | C0140 |
| **Premium written** | | | | |
| Gross - Direct Business | R0110 | 1,253 | 4,335 | 5,588 |
| Gross - Proportional reinsurance accepted | R0120 | | | |
| Gross - Non-proportional reinsurance accepted | R0130 | | | |
| Reinsurers' share | R0140 | 1,501 | 4,191 | 5,692 |
| **Net** | **R0200** | **(248)** | **144** | **(104)** |
| **Premium earned** | | | | |
| Gross - Direct Business | R0210 | 27,025 | 4,814 | 31,839 |
| Gross - Proportional reinsurance accepted | R0220 | | | |
| Gross - Non-proportional reinsurance accepted | R0230 | | | |
| Reinsurers' share | R0240 | 22,920 | 4,336 | 27,256 |
| **Net** | **R0300** | **4,105** | **478** | **4,583** |
| **Claims incurred** | | | | |
| Gross - Direct Business | R0310 | | | |
| Gross - Proportional reinsurance accepted | R0320 | | | |
| Gross - Non-proportional reinsurance accepted | R0330 | | | |
| Reinsurers' share | R0340 | | | |
| **Net** | **R0400** | | | |
| **Changes in other technical provisions** | | | | |
| Gross - Direct Business | R0410 | 1,477 | | 1,477 |
| Gross - Proportional reinsurance accepted | R0420 | | | |
| Gross - Non-proportional reinsurance accepted | R0430 | | | |
| Reinsurers' share | R0440 | 11 | | 11 |
| **Net** | **R0500** | **1,466** | | **1,466** |
| **Expenses incurred** | **R0550** | 814 | | 814 |
| **Other expenses** | **R1200** | | | |
| **Total expenses** | **R1300** | | | |

## Non - life Technical Provisions
## S.17.01.02
## GBP £'000

| | | Direct business and accepted proportional reinsurance | Total Non-Life obligations |
|---|---|---|---|
| | | Credit and suretyship insurance | |
| | | C0100 | C0180 |
| **Technical provisions calculated as a whole** | **R0010** | | |
| Total Recoverables from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default associated to TP as a whole | R0050 | | |
| **Technical Provisions calculated as a sum of BE and RM** | | | |
| **Best estimate** | | | |
| **Premium provisions** | | | |
| Gross - Total | R0060 | **(132,420)** | **(132,420)** |
| Total recoverable from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default | R0140 | (47,417) | **(47,417)** |
| **Net Best Estimate of Premium Provisions** | **R0150** | **(85,003)** | **(85,003)** |
| **Claims provisions** | | | |
| Gross - Total | R0160 | **6,085** | **6,085** |
| Total recoverable from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default | R0240 | (3,663) | **(3,663)** |
| **Net Best Estimate of Claims Provisions** | R0250 | **9,748** | **9,748** |
| **Total Best estimate - gross** | R0260 | **(126,335)** | **(126,335)** |
| **Total Best estimate - net** | **R0270** | **(75,255)** | **(75,255)** |
| **Risk margin** | **R0280** | 210,974 | **210,974** |
| **Amount of the transitional on Technical Provisions** | | | |
| **TP as a whole** | **R0290** | | |
| **Best estimate** | **R0300** | | |
| **Risk margin** | **R0310** | | |
| **Technical provisions - total** | | | |
| Technical provisions - total | R0320 | **84,639** | **84,639** |
| Recoverable from reinsurance contract/SPV and Finite Re after the adjustment for expected losses due to counterparty default - total | R0330 | **(51,080)** | **(51,080)** |
| Technical provisions minus recoverables from reinsurance/SPV and Finite Re- total | R0340 | **135,719** | **135,719** |

# Non-life Insurance Claims Information (by Accident Year)
# S.19.01.21
# GBP £'000

**Gross Claims Paid (non-cumulative) (absolute amount)**

| | | Development year | | | | | | | | | | | | In Current year | Sum of years (cumulative) |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | 0 | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 & + | | | |
| | | C0010 | C0020 | C0030 | C0040 | C0050 | C0060 | C0070 | C0080 | C0090 | C0100 | C0110 | | C0170 | C0180 |
| Prior | R0100 | | | | | | | | | | | (2,899) | R0100 | (2,899) | (2,899) |
| 2009 | R0160 | 7,326 | | | | | | | | | | | R0160 | | 7,326 |
| 2010 | R0170 | | | | | | | | | | | | R0170 | | |
| 2011 | R0180 | 1,024 | 195,405 | | | | | | | | | | R0180 | | 196,429 |
| 2012 | R0190 | 6,337 | | | | | | | | | | | R0190 | | 6,337 |
| 2013 | R0200 | 97,668 | | | | | | | | | | | R0200 | | 97,668 |
| 2014 | R0210 | 11,439 | | | | | | | | | | | R0210 | | 11,439 |
| 2015 | R0220 | | | | | | | | | | | | R0220 | | |
| 2016 | R0230 | 1,251 | | | | | | | | | | | R0230 | | 1,251 |
| 2017 | R0240 | 219 | 430 | | | | | | | | | | R0240 | 430 | 649 |
| 2018 | R0250 | | | | | | | | | | | | R0250 | | |
| | | | | | | | | | | | | | **Total** R0260 | **(2,469)** | **318,200** |

# Non-life Insurance Claims Information (by Accident Year)(continued)
# S.19.01.21
# GBP £'000

Gross undiscounted Best Estimate Claims Provisions (absolute amounts)

| | | Development year | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | 0 | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 & + | |
| | | C0200 | C0210 | C0220 | C0230 | C0240 | C0250 | C0260 | C0270 | C0280 | C0290 | C0300 | |
| Prior | R0100 | | | | | | | | | | | 14,355 | |
| 2009 | R0160 | | | | | | | | | | | | |
| 2010 | R0170 | | | | | | | | | | | | |
| 2011 | R0180 | | | | | | | | | | | | |
| 2012 | R0190 | | | | | | | | | | | | |
| 2013 | R0200 | | | | | | | | | | | | |
| 2014 | R0210 | | | | | | | | | | | | |
| 2015 | R0220 | | | | | | | | | | | | |
| 2016 | R0230 | | | | | | | | | | | | |
| 2017 | R0240 | | | | | | | | | | | | |
| 2018 | R0250 | | | | | | | | | | | | |

| | | Year end (discounted data) |
|---|---|---|
| | | C0360 |
| | R0100 | 6,084 |
| | R0160 | |
| | R0170 | |
| | R0180 | |
| | R0190 | |
| | R0200 | |
| | R0210 | |
| | R0220 | |
| | R0230 | |
| | R0240 | |
| | R0250 | |
| Total | R0260 | **6,084** |

# Own funds
# S.23.01.01
# GBP £'000

| | | Total | Tier 1 - unrestricted | Tier 1 - restricted | Tier 2 | Tier 3 |
|---|---|---|---|---|---|---|
| | | C0010 | C0020 | C0030 | C0040 | C0050 |
| **Basic own funds before deduction for participations in other financial sector as foreseen in article 68 of Delegated Regulation (EU) 2015/35** | | | | | | |
| Ordinary share capital (gross of own shares) | R0010 | **55,000** | 55,000 | | | |
| Share premium account related to ordinary share capital | R0030 | | | | | |
| Initial funds, members' contributions or the equivalent basic own - fund item for mutual and mutual-type undertakings | R0040 | | | | | |
| Subordinated mutual member accounts | R0050 | | | | | |
| Surplus funds | R0070 | | | | | |
| Preference shares | R0090 | | | | | |
| Share premium account related to preference shares | R0110 | | | | | |
| Reconciliation reserve | R0130 | **620,161** | 620,161 | | | |
| Subordinated liabilities | R0140 | | | | | |
| An amount equal to the value of net deferred tax assets | R0160 | **17,376** | | | | 17,376 |
| Other own fund items approved by the supervisory authority as basic own funds not specified above | R0180 | | | | | |
| **Own funds from the financial statements that should not be represented by the reconciliation reserve and do not meet the criteria to be classified as Solvency II own funds** | | | | | | |
| Own funds from the financial statements that should not be represented by the reconciliation reserve and do not meet the criteria to be classified as Solvency II own funds | R0220 | | | | | |
| **Deductions** | | | | | | |
| Deductions for participations in financial and credit institutions | R0230 | | | | | |
| **Total basic own funds after deductions** | **R0290** | **692,537** | **675,161** | | | **17,376** |
| **Ancillary own funds** | | | | | | |
| Unpaid and uncalled ordinary share capital callable on demand | R0300 | | | | | |
| Unpaid and uncalled initial funds, members' contributions or the equivalent basic own fund item for mutual and mutual - type undertakings, callable on demand | R0310 | | | | | |
| Unpaid and uncalled preference shares callable on demand | R0320 | | | | | |
| A legally binding commitment to subscribe and pay for subordinated liabilities on demand | R0330 | | | | | |
| Letters of credit and guarantees under Article 96(2) of the Directive 2009/138/EC | R0340 | | | | | |
| Letters of credit and guarantees other than under Article 96(2) of the Directive 2009/138/EC | R0350 | | | | | |
| Supplementary members calls under first subparagraph of Article 96(3) of the Directive 2009/138/EC | R0360 | | | | | |
| Supplementary members calls - other than under first subparagraph of Article 96(3) of the Directive 2009/138/EC | R0370 | | | | | |
| Other ancillary own funds | R0390 | | | | | |
| **Total ancillary own funds** | **R0400** | | | | | |

## Own funds (continued)
## S.23.01.01
## GBP £'000

| | | Total | Tier 1 - unrestricted | Tier 1 - restricted | Tier 2 | Tier 3 |
|---|---|---|---|---|---|---|
| | | C0010 | C0020 | C0030 | C0040 | C0050 |
| **Available and eligible own funds** | | | | | | |
| **Total available own funds to meet the SCR** | **R0500** | **692,537** | **675,161** | | | **17,376** |
| **Total available own funds to meet the MCR** | **R0510** | **675,161** | **675,161** | | | |
| **Total eligible own funds to meet the SCR** | **R0540** | **692,537** | **675,161** | | | **17,376** |
| **Total eligible own funds to meet the MCR** | **R0550** | **675,161** | **675,161** | | | |
| **SCR** | **R0580** | **301,332** | | | | |
| **MCR** | **R0600** | **75,333** | | | | |
| **Ratio of Eligible own funds to SCR** | **R0620** | **229.83%** | | | | |
| **Ratio of Eligible own funds to MCR** | **R0640** | **896.23%** | | | | |

| | | C0060 | |
|---|---|---|---|
| **Reconciliation reserve** | | | |
| Excess of assets over liabilities | R0700 | **692,537** | |
| Own shares (held directly and indirectly) | R0710 | | |
| Foreseeable dividends, distributions and charges | R0720 | | |
| Other basic own fund items | R0730 | **72,376** | |
| Adjustment for restricted own fund items in respect of matching adjustment portfolios and ring fenced funds | R0740 | | |
| **Reconciliation reserve** | **R0760** | **620,161** | |
| **Expected profits** | | | |
| Expected profits included in future premiums (EPIFP) - Life Business | R0770 | | |
| Expected profits included in future premiums (EPIFP) - Non- life business | R0780 | 212,254 | |
| | | | |
| **Total Expected profits included in future premiums (EPIFP)** | **R0790** | **212,254** | |

## Solvency Capital Requirement - for undertakings on Standard Formula
## S.25.01.21
## GBP £'000

| | | Gross solvency capital requirement | USP | Simplifications |
|---|---|---|---|---|
| | | C0110 | C0090 | C0100 |
| Market risk | R0010 | 87,442 | | |
| Counterparty default risk | R0020 | 1,394 | | |
| Life underwriting risk | R0030 | | | |
| Health underwriting risk | R0040 | | | |
| Non-life underwriting risk | R0050 | 265,342 | | |
| Diversification | R0060 | (54,034) | | |
| Intangible asset risk | R0070 | | | |
| **Basic Solvency Capital Requirement** | **R0100** | **300,144** | | |

### Calculation of Solvency Capital Requirement

| | | C0100 |
|---|---|---|
| Operational risk | R0130 | 1,189 |
| Loss-absorbing capacity of technical provisions | R0140 | |
| Loss-absorbing capacity of deferred taxes | R0150 | |
| Capital requirement for business operated in accordance with Art. 4 of Directive 2003/41/EC | R0160 | |
| **Solvency capital requirement excluding capital add-on** | **R0200** | **301,332** |
| Capital add-on already set | R0210 | |
| **Solvency capital requirement** | **R0220** | **301,332** |
| **Other information on SCR** | | |
| Capital requirement for duration-based equity risk sub-module | R0400 | |
| Total amount of Notional Solvency Capital Requirements for remaining part | R0410 | |
| Total amount of Notional Solvency Capital Requirements for ring fenced funds | R0420 | |
| Total amount of Notional Solvency Capital Requirements for matching adjustment portfolios | R0430 | |
| Diversification effects due to RFF nSCR aggregation for article 304 | R0440 | |

# Minimum Capital Requirement - Only life or only non-life insurance or reinsurance activity
# S.28.01.01
# GBP £'000

**Linear formula component for non-life insurance and reinsurance obligations**

| MCR calculation Non Life | | Non-life activities | |
|---|---|---|---|
| | | Net (of reinsurance/SPV) best estimate and TP calculated as a whole | Net (of reinsurance) written premiums in the last 12 months |
| | | C0020 | C0030 |
| Medical expense insurance and proportional reinsurance | R0020 | | |
| Income protection insurance and proportional reinsurance | R0030 | | |
| Workers' compensation insurance and proportional reinsurance | R0040 | | |
| Motor vehicle liability insurance and proportional reinsurance | R0050 | | |
| Other motor insurance and proportional reinsurance | R0060 | | |
| Marine, aviation and transport insurance and proportional reinsurance | R0070 | | |
| Fire and other damage to property insurance and proportional reinsurance | R0080 | | |
| General liability insurance and proportional reinsurance | R0090 | | |
| Credit and suretyship insurance and proportional reinsurance | R0100 | | |
| Legal expenses insurance and proportional reinsurance | R0110 | | |
| Assistance and proportional reinsurance | R0120 | | |
| Miscellaneous financial loss insurance and proportional reinsurance | R0130 | | |
| Non-proportional health reinsurance | R0140 | | |
| Non-proportional casualty reinsurance | R0150 | | |
| Non-proportional marine, aviation and transport reinsurance | R0160 | | |
| Non-proportional property reinsurance | R0170 | | |

**Linear formula component for life insurance and reinsurance obligations**

| MCR calculation Life | | Life activities | |
|---|---|---|---|
| | | Net (of reinsurance/SPV) best estimate and TP calculated as a whole | Net (of reinsurance/SPV) total capital at risk |
| | | C0050 | C0060 |
| Obligations with profit participation - guaranteed benefits | R0210 | | |
| Obligations with profit participation - future discretionary benefits | R0220 | | |
| Index-linked and unit-linked insurance obligations | R0230 | | |
| Other life (re)insurance and health (re)insurance obligations | R0240 | | |
| Total capital at risk for all life (re)insurance obligations | R0250 | | |

| | | Non-life activities | Life activities |
|---|---|---|---|
| | | C0010 | C0040 |
| MCRNL Result | R0010 | | |
| MCRL Result | R0200 | | |

| **Overall MCR calculation** | | **C0070** |
|---|---|---|
| Linear MCR | R0300 | |
| SCR | R0310 | 301,332 |
| MCR cap | R0320 | 135,600 |
| MCR floor | R0330 | 75,333 |
| Combined MCR | R0340 | 75,333 |
| Absolute floor of the MCR | R0350 | 3,288 |
| | | **C0070** |
| **Minimum Capital Requirement** | **R0400** | **75,333** |

**Approval by the Board of Directors of the Solvency and Financial Condition Report**

**Year ended 31 December 2018**

We acknowledge our responsibility for preparing this Solvency and Financial Condition Report in all material respects in accordance with the PRA Rules and the Solvency II Regulations as applicable to the Company. We are satisfied that (a) throughout the financial year in question, the Company has complied in all material respects with the requirements of the PRA Rules and the Solvency II Regulations applicable to the Company; and (b) it is reasonable to believe that, at the date of the publication of this Solvency and Financial Condition Report, the Company has continued so to comply subsequently and will continue so to comply in the future.

For and on behalf of Assured Guaranty (Europe) plc
Director
London
On 12 April 2019