

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2020
OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission file number: 001-38788



Watford Holdings Ltd.

(Exact Name of Registrant as Specified in its Charter)

Bermuda
(State or other jurisdiction
of incorporation or organization)

98-1155442
(I.R.S. Employer Identification Number)

Waterloo House, 1st Floor
100 Pitts Bay Road, Pembroke HM 08, Bermuda
(Address of principal executive offices)

(441) 278-3455
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common Shares	WTRE	Nasdaq Global Select Market
8½% Cumulative Redeemable Preference Shares	WTREP	Nasdaq Global Select Market

As of May 11, 2020, there were 19,886,979 common shares, \$0.01 par value per share, of the registrant outstanding.

Watford Holdings Ltd.

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Explanatory note - Certain defined terms

Unless the context suggests otherwise, any reference in this report to:

- “ACGL” refers to Arch Capital Group Ltd. and its controlled subsidiaries;
- “Arch” refers to any one or more of the following direct or indirect subsidiaries of ACGL, as applicable in the context in which such term appears:
 - Arch Investment Management Ltd., or AIM, which manages the majority of our investment grade portfolio;
 - Arch Reinsurance Company, or ARC, which is a party to certain quota share agreements with one or more of our operating subsidiaries and a services agreement with Watford Holdings (U.S.) Inc.;
 - Arch Reinsurance Ltd., or ARL, which is a party to certain quota share agreements with one or more of our operating subsidiaries and owned approximately 12.6% of our outstanding common shares as of March 31, 2020;
 - Arch Underwriters Inc., or AUI, which manages the underwriting business of our U.S. operating subsidiaries;
 - Arch Underwriters Ltd., or AUL, which manages the underwriting business of our non-U.S. operating subsidiaries, including Watford Re;
- “HPS” refers to HPS Investment Partners, LLC (formerly known as Highbridge Principal Strategies, LLC), which manages our non-investment grade portfolio, as well as accounts in our investment grade portfolio;
- our “Investment Managers” refers to AIM, HPS or any other investment managers that manage our investment grade portfolio or our non-investment grade portfolio from time to time;
- “Watford,” “we,” “us” and “our” refers to Watford Holdings Ltd. and its subsidiaries;
- “Watford Holdings” refers to our company, Watford Holdings Ltd., a Bermuda exempted company;
- “Watford Re” refers to Watford Re Ltd., a Bermuda domiciled insurance company and a wholly-owned subsidiary of our company;
- “Watford Trust” refers to Watford Asset Trust I, a statutory trust organized under the laws of the State of Delaware;
- “WIC” refers to Watford Insurance Company, a New Jersey domiciled insurance company and a wholly-owned subsidiary of our company;
- “WICE” refers to Watford Insurance Company Europe Limited, a Gibraltar domiciled insurance company and a wholly-owned subsidiary of our company; and
- “WSIC” refers to Watford Specialty Insurance Company, a New Jersey domiciled insurance company and a wholly-owned subsidiary of our company.

Part I. Financial information

Cautionary note regarding forward-looking statements

The Private Securities Litigation Reform Act of 1995 (or the PSLRA) provides a “safe harbor” for forward-looking statements. This report contains forward-looking statements that are intended to enhance the reader’s ability to assess our future financial and business performance. These statements are based on the beliefs and assumptions of our management, and are subject to risks and uncertainties. Generally, statements that are not about historical facts, including statements concerning our possible or assumed future actions or results of operations are forward-looking statements. Forward-looking statements include, but are not limited to, statements that represent our beliefs, expectations or estimates concerning future operations, strategies, financial results or performance, financings, investments, acquisitions, expenditures or other developments and anticipated trends and competition in the markets in which we operate. Forward-looking statements, for purposes of the PSLRA or otherwise, can also be identified by the use of forward-looking terminology such as “may,” “believes,” “intends,” “anticipates,” “plans,” “estimates,” “expects,” “should” or similar expressions.

Forward-looking statements involve our current assessment of risks and uncertainties. Actual events and results may differ materially from those expressed or implied in these statements. Important factors that could cause actual events or results to differ materially from those indicated in such statements are discussed below and elsewhere in this report and in our other reports and other documents filed with the Securities and Exchange Commission, or the SEC, and include:

- our limited operating history;
- fluctuations in the results of our operations;
- our ability to compete successfully with more established competitors;
- our losses exceeding our reserves;
- downgrades, potential downgrades or other negative actions by rating agencies, including the recent announcements by A.M. Best Company, or A.M. Best, that it has placed under review with negative implications our financial strength and credit ratings and Kroll Bond Rating Agency, or KBRA, that it has placed on watch our financial strength and credit ratings;
- our dependence on key executives and inability to attract qualified personnel, or the potential loss of suitably qualified personnel as a result of Bermuda employment and immigration restrictions;
- our dependence on letter of credit facilities and borrowing facilities that may not be available on commercially acceptable terms;
- our potential inability to pay dividends or distributions;
- our potential need for additional capital in the future and the potential unavailability of such capital to us on favorable terms or at all;
- our dependence on clients’ evaluations of risks associated with such clients’ insurance underwriting;
- the suspension or revocation of our subsidiaries’ insurance licenses;
- Watford Holdings potentially being deemed an investment company under U.S. federal securities law;

- the potential characterization of us and/or any of our subsidiaries as a passive foreign investment company, or PFIC;
- our dependence on Arch for services critical to our underwriting operations;
- changes to our strategic relationship with Arch or the termination by Arch of any of our services agreements or quota share agreements;
- our dependence on HPS and AIM to implement our investment strategy;
- the termination by HPS or AIM of any of our investment management agreements;
- risks associated with our investment strategy being greater than those faced by competitors;
- changes in the regulatory environment;
- our potentially becoming subject to U.S. federal income taxation;
- our potentially becoming subject to U.S. withholding and information reporting requirements under the U.S. Foreign Account Tax Compliance Act, or FATCA, provisions;
- our ability to complete acquisitions and integrate businesses successfully;
- adverse general economic and market conditions, including those caused by pandemics, including the current global pandemic related to the novel coronavirus, or COVID-19, and government actions in response thereto; and
- the other matters set forth under Item 1A “Risk factors,” Item 7 “Management’s discussion and analysis of financial condition and results of operations,” and other sections of the Company’s Annual Report on Form 10-K for the year ended December 31, 2019, Part II Item 1A “Risk factors” and Part I Item 2 “Management’s discussion and analysis of financial condition and results of operations” of this Form 10-Q as well as the other factors set forth in the Company’s other documents on file with the SEC, and management’s response to any of the aforementioned factors.

Consequently, such forward-looking statements should be regarded solely as our current plans, estimates or belief as of the date of this report. All subsequent forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by these cautionary statements. The foregoing review of important factors should not be construed as exhaustive and should be read in conjunction with other cautionary statements that are included herein or elsewhere. We do not intend, and do not undertake, any obligation to update any forward-looking statements to reflect future events or circumstances after the date of this report.

Item 1. Consolidated financial statements

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WATFORD HOLDINGS LTD.
CONSOLIDATED BALANCE SHEETS
(U.S. dollars in thousands, except share data)

	(Unaudited)	
	March 31, 2020	December 31, 2019
Assets		
Investments:		
Term loans, fair value option (Amortized cost: \$1,113,510 and \$1,113,212)	\$ 906,999	\$ 1,061,934
Fixed maturities, fair value option (Amortized cost: \$504,750 and \$432,576)	392,452	416,594
Short-term investments, fair value option (Cost: \$348,059 and \$325,542)	343,861	329,303
Equity securities, fair value option	58,091	59,799
Other investments, fair value option (1)	30,682	30,461
Investments, fair value option	1,732,085	1,898,091
Fixed maturities, available for sale (Amortized cost: \$749,835 and \$739,456)	717,552	745,708
Equity securities, fair value through net income	63,169	65,338
Total investments (1)	2,512,806	2,709,137
Cash and cash equivalents	96,580	102,437
Accrued investment income	16,344	14,025
Premiums receivable (1)	281,541	273,657
Reinsurance recoverable on unpaid and paid losses and loss adjustment expenses (1)	197,458	170,974
Prepaid reinsurance premiums (1)	128,570	132,577
Deferred acquisition costs, net (1)	71,402	64,044
Receivable for securities sold	26,789	16,288
Intangible assets	7,650	7,650
Funds held by reinsurers (1)	40,520	42,505
Other assets	27,287	17,562
Total assets	\$ 3,406,947	\$ 3,550,856
Liabilities		
Reserve for losses and loss adjustment expenses (1)	\$ 1,300,249	\$ 1,263,628
Unearned premiums (1)	478,663	438,907
Losses payable (1)	46,424	61,314
Reinsurance balances payable (1)	71,204	77,066
Payable for securities purchased	63,829	18,180
Payable for securities sold short	30,076	66,257
Revolving credit agreement borrowings	576,486	484,287
Senior notes (1)	172,486	172,418
Amounts due to affiliates (1)	4,168	4,467
Investment management and performance fees payable (1)	5,428	17,762
Other liabilities (1)	41,552	21,912
Total liabilities	\$ 2,790,565	\$ 2,626,198
Commitments and contingencies		
Contingently redeemable preference shares (1)	52,328	52,305
Shareholders' equity		
Common shares (\$0.01 par; shares authorized: 120 million; shares issued: 22,703,170 and 22,692,300)	227	227
Additional paid-in capital	898,693	898,083
Retained earnings (deficit)	(224,737)	43,470
Accumulated other comprehensive income (loss)	(32,206)	5,629
Common shares held in treasury, at cost (shares: 2,917,149 and 2,789,405)	(77,923)	(75,056)
Total shareholders' equity	564,054	872,353
Total liabilities, contingently redeemable preference shares and shareholders' equity	\$ 3,406,947	\$ 3,550,856

(1) See Note 12, "Transactions with related parties" for disclosure of related party amounts.

WATFORD HOLDINGS LTD.
CONSOLIDATED STATEMENTS OF INCOME (LOSS)
(U.S. dollars in thousands, except share and per share data)

	(Unaudited)	
	Three Months Ended March 31,	
	2020	2019
Revenues		
Gross premiums written (1)	\$ 234,902	\$ 186,689
Gross premiums ceded (1)	(48,202)	(41,302)
Net premiums written	186,700	145,387
Change in unearned premiums (1)	(46,661)	707
Net premiums earned (1)	140,039	146,094
Other underwriting income (loss)	133	592
Interest income	37,824	43,141
Investment management fees - related parties (1)	(4,352)	(4,409)
Borrowing and miscellaneous other investment expenses	(5,669)	(8,298)
Net interest income	27,803	30,434
Realized and unrealized gains (losses) on investments	(290,502)	33,720
Investment performance fees - related parties (1)	—	(5,800)
Net investment income (loss)	(262,699)	58,354
Total revenues	(122,527)	205,040
Expenses		
Loss and loss adjustment expenses (1)	(110,676)	(110,850)
Acquisition expenses (1)	(28,367)	(33,974)
General and administrative expenses (1)	(7,139)	(7,240)
Interest expense (1)	(2,912)	—
Net foreign exchange gains (losses)	5,013	(437)
Total expenses	(144,081)	(152,501)
Income (loss) before income taxes	(266,608)	52,539
Income tax expense	—	—
Net income (loss) before preference dividends	(266,608)	52,539
Preference dividends (1)	(1,171)	(4,907)
Net income (loss) available to common shareholders	\$ (267,779)	\$ 47,632
Earnings (loss) per common share:		
Basic and diluted	\$ (13.42)	\$ 2.10
Weighted average number of common shares used in the determination of earnings (loss) per share:		
Basic and diluted	19,951,932	22,682,875

(1) See Note 12, "Transactions with related parties" for disclosure of related party amounts.

See Notes to Consolidated Financial Statements

WATFORD HOLDINGS LTD.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(U.S. dollars in thousands)

	(Unaudited)	
	Three Months Ended March 31,	
	2020	2019
Comprehensive income (loss)		
Net income (loss) available to common shareholders	\$ (267,779)	\$ 47,632
Other comprehensive income (loss) net of income tax:		
Available for sale investments:		
Unrealized holding gains (losses) arising during the year	(28,431)	3,915
Unrealized foreign currency gains (losses) arising during the year	(7,699)	1,130
Credit loss recognized in net income (loss)	563	—
Reclassification of net realized (gains) losses, net of income taxes, included in net income (loss)	(2,405)	(229)
Unrealized holding gains (losses) of available for sale investments	(37,972)	4,816
Foreign currency translation adjustments	137	(165)
Other comprehensive income (loss) net of income tax	(37,835)	4,651
Comprehensive income (loss)	\$ (305,614)	\$ 52,283

See Notes to Consolidated Financial Statements

WATFORD HOLDINGS LTD.
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
(U.S. dollars in thousands)

	(Unaudited)	
	Three Months Ended March 31,	
	2020	2019
Common shares		
Balance at beginning of period	\$ 227	\$ 227
Common shares issued	—	—
Balance at end of period	227	227
Additional paid-in capital		
Balance at beginning of period	898,083	895,386
Common shares issued under share plans	250	—
Share-based compensation	360	—
Balance at end of period	898,693	895,386
Accumulated other comprehensive income (loss)		
Balance at beginning of period	5,629	(4,730)
Unrealized holding gains (losses) of available for sale investments:		
Balance at beginning of period	6,252	(4,158)
Unrealized holding gains (losses) of available for sale investments, net of reclassification adjustments	(37,972)	4,816
Balance at end of period	(31,720)	658
Currency translation adjustment:		
Balance at beginning of period	(623)	(572)
Currency translation adjustment	137	(165)
Balance at end of period	(486)	(737)
Balance at end of period	(32,206)	(79)
Common shares held in treasury, at cost		
Balance at beginning of period	(75,056)	—
Shares repurchased for treasury	(2,867)	—
Balance at end of period	(77,923)	—
Retained earnings (deficit)		
Balance at beginning of period	43,470	(1,275)
Cumulative effect of adoption of updated accounting guidance for credit losses at January 1, 2020	(428)	—
Net income (loss) before preference dividends	(266,608)	52,539
Preference share dividends paid and accrued	(1,171)	(4,907)
Balance at end of period	(224,737)	46,357
Total shareholders' equity	\$ 564,054	\$ 941,891

See Notes to Consolidated Financial Statements

WATFORD HOLDINGS LTD.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(U.S. dollars in thousands)

	(Unaudited)	
	Three Months Ended March 31,	
	2020	2019
Operating Activities		
Net income (loss) before preference dividends	\$ (266,608)	\$ 52,539
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Net realized and unrealized (gains) losses on investments	290,502	(33,720)
Amortization of fixed assets	1	38
Share-based compensation	610	—
Changes in:		
Accrued investment income	(2,329)	2,121
Premiums receivable	(16,272)	(22,686)
Reinsurance recoverable on unpaid and paid losses and loss adjustment expenses	(23,069)	(16,703)
Prepaid reinsurance premiums	4,007	(11,374)
Deferred acquisition costs, net	(7,995)	471
Reserve for losses and loss adjustment expenses	60,178	67,964
Unearned premiums	42,654	10,667
Reinsurance balances payable	(6,901)	6,069
Funds held with reinsurers	(2,868)	598
Other liabilities	(27,662)	18,353
Other items	(19,673)	(4,031)
Net Cash Provided By Operating Activities	24,575	70,306
Investing Activities		
Purchase of term loans	(86,702)	(72,168)
Purchase of fixed maturity investments	(328,927)	(306,656)
Purchase of short-term investments with maturities over three months	(36,119)	—
Proceeds from sale, redemptions and maturity of term loans	98,992	48,630
Proceeds from sales, redemptions and maturities of fixed maturity investments	215,719	303,076
Proceeds from sales, redemptions and maturities of short-term investments with maturities over three months	5,596	25,000
Net (purchases) sales of short-term investments with maturities less than three months	22,337	504
Purchases of equity securities	(6,388)	(38,399)
Proceeds from sales of equity securities	1,531	7,312
Net settlements of derivative instruments	2,336	824
Purchases of furniture, equipment and other assets	(2)	—
Net Cash Provided by (Used For) Investing Activities	(111,627)	(31,877)
Financing Activities		
Dividends paid on redeemable preference shares	(1,148)	(4,816)
Repayments on borrowings	—	(100,102)
Proceeds from borrowings	92,199	59,000
Purchases of common shares under share repurchase program	(2,867)	—
Net Cash Provided By (Used For) Financing Activities	88,184	(45,918)
Effects of exchange rate changes on foreign currency cash	(6,989)	261
Increase (decrease) in cash	(5,857)	(7,228)
Cash and cash equivalents, beginning of period	102,437	63,529
Cash and cash equivalents, end of period	\$ 96,580	\$ 56,301
Supplementary information		
Income taxes paid	\$ —	\$ —
Interest paid	\$ 5,422	\$ 7,864
Non-cash exchange of investments	\$ 13,467	\$ —

See Notes to Consolidated Financial Statements

WATFORD HOLDINGS LTD.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
(U.S. dollars in thousands, except share data)

1. Organization

Watford Holdings Ltd. (the “Parent”) and its wholly-owned subsidiary, Watford Re Ltd. (“Watford Re”), were incorporated under the laws of Bermuda on July 19, 2013.

As used herein, the terms “Company” or “Companies,” or “we,” “us” and “our,” collectively refer to the Parent and/or, as applicable, its subsidiaries. Watford Re is licensed as a Class 4 multi-line insurer under the Insurance Act 1978 of Bermuda, as amended, and related regulations (the “Insurance Act”) and is licensed to underwrite general business on an insurance and reinsurance basis. Through Watford Re, the Company primarily underwrites reinsurance on exposures worldwide.

On March 28, 2019, the Company completed a direct listing of its common shares on the Nasdaq Global Select Market. On June 28, 2019, the Company completed a direct listing of its 8½% Cumulative Redeemable Preference Shares (the “preference shares”) on the Nasdaq Global Select Market. The Company did not issue any new common shares or preference shares, nor did the Company receive any proceeds from the sale of common shares or preference shares by the selling shareholders.

Watford Re and Watford Insurance Company Europe Limited (“WICE”) have engaged Arch Underwriters Ltd. (“AUL”), a company incorporated in Bermuda and a wholly-owned subsidiary of Arch Capital Group Ltd. (“ACGL”), to act as their insurance and reinsurance manager pursuant to services agreements between AUL and Watford Re and WICE, respectively. AUL manages the day-to-day underwriting activities of Watford Re and WICE, subject to the provisions of the services agreement and the oversight of our board of directors. See Note 12, “Transactions with related parties” for further details.

In May 2018, WICE formed a branch in Romania and commenced underwriting operations in June 2018. WICE is a wholly-owned subsidiary of Watford Re.

Watford Specialty Insurance Company (“WSIC”) and Watford Insurance Company (“WIC”), which are wholly-owned, indirect subsidiaries of Watford Re, have engaged Arch Underwriters Inc. (“AUI”), a company incorporated in Delaware and a wholly-owned subsidiary of ACGL, to act as their insurance and reinsurance manager pursuant to services agreements between AUI and WSIC and WIC, respectively. AUI manages the day-to-day underwriting activities of WSIC and WIC, subject to the provisions of the services agreement and the oversight of our board of directors. See Note 12, “Transactions with related parties” for further details.

The Company has engaged HPS Investment Partners, LLC (“HPS”), as investment manager of the assets in its non-investment grade portfolio pursuant to various investment management agreements. HPS invests the Company’s non-investment grade assets and a portion of its investment grade assets, subject to the terms of the applicable investment management agreements. See Note 12, “Transactions with related parties” for further details.

The Company has engaged Arch Investment Management Ltd. (“AIM”), a Bermuda exempted company and a subsidiary of ACGL, as investment manager of assets in its investment grade portfolio pursuant to various investment management agreements. AIM manages the majority of the Company’s investment grade assets pursuant to the terms of the investment management agreements with AIM. See Note 12, “Transactions with related parties” for further details.

The results for the three months ended March 31, 2020 are not necessarily indicative of the results expected for the full calendar year.

WATFORD HOLDINGS LTD.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
(U.S. dollars in thousands, except share data)

2. Basis of presentation and significant accounting policies

There has been no material change to the Company's significant accounting policies as described in its audited consolidated financial statements and the accompanying notes as of December 31, 2019 and 2018 and for each of the years in the periods ended December 31, 2019, 2018 and 2017, except as noted below.

(a) Basis of presentation

The unaudited interim consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America ("GAAP") on a basis consistent with reporting interim financial information in accordance with instructions to Form 10-Q and Article 10 of Regulation S-X under the Securities and Exchange Act of 1934, as amended. All significant intercompany transactions and balances have been eliminated on consolidation. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates and assumptions. In the opinion of management, the accompanying unaudited interim consolidated financial statements reflect all adjustments (consisting of recurring accruals) necessary for a fair statement of results on an interim basis.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted; however management believes that the disclosures are adequate to make the information presented not misleading. This report should be read in conjunction with the Company's audited consolidated financial statements and the accompanying notes for the years ended December 31, 2019, 2018 and 2017.

To facilitate comparison of information across periods, certain reclassifications have been made to prior year amounts to conform to the current year's presentation.

(b) Recent accounting pronouncements

Issued and effective as of March 31, 2020 - Credit Losses

Financial Instruments - Credit Losses: Measurement of Credit Losses on Financial Instruments

The Company adopted ASU 2016-13, *Financial Instruments - Credit Losses (Topic 326)* ("ASU 2016-13") which was issued in June 2016. This ASU applies a new credit loss model (current expected credit losses, or "CECL") for determining credit-related impairments for financial instruments measured at amortized cost (including reinsurance recoverables) and requires an entity to estimate the credit losses expected over the life of an exposure or pool of exposures. The estimate of expected credit losses should consider historical information, current information, as well as reasonable and supportable forecasts, including estimates of prepayments. The expected credit losses, and subsequent adjustments to such losses, are recorded through an allowance account that is deducted from the amortized cost basis of the financial asset, with the net carrying value of the financial asset presented on the Company's consolidated balance sheet.

This ASU also amends the previous other-than-temporary impairment model for available for sale debt securities by requiring the recognition of impairments relating to credit losses through an allowance account and limiting the amount of credit loss to the difference between a security's amortized cost basis and its fair value. In addition, the length of time a security has been in an unrealized loss position will no longer impact the determination of whether a credit loss exists.

The Company adopted this ASU for the quarter ending March 31, 2020. For available for sale debt securities, the updated guidance was applied prospectively. For financial instruments measured at amortized cost, the updated guidance was applied by recognizing a cumulative effect adjustment

WATFORD HOLDINGS LTD.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
(U.S. dollars in thousands, except share data)

of \$0.4 million, net of tax, to the opening balance of retained earnings as of January 1, 2020, the beginning of the period of adoption. This adjustment is associated with “premiums receivable” and “reinsurance recoverables on unpaid and paid losses and loss adjustment expenses” in the Company’s consolidated balance sheets. The cumulative effect adjustment decreased retained earnings as of January 1, 2020 and increased the allowance for estimated uncollectible reinsurance.

The following accounting policies have been updated to reflect the Company’s adoption of ASU 2016-13, as described above. Results for the reporting periods beginning January 1, 2020 and thereafter are presented under ASC 326, while prior period amounts continue to be reported in accordance with previous applicable GAAP.

Investment Impairments

The Company conducts a periodic review to identify and evaluate invested assets that may have credit impairments.

Credit Impairments of Available For Sale Fixed Maturities

The Company derives estimated credit losses for fixed maturities by comparing expected future cash flows to be collected to the amortized cost of the security. Estimates of expected future cash flows consider among other things, macroeconomic conditions as well as the financial condition, near-term and long-term prospects for the issuer, and the likelihood of the recoverability of principal and interest.

Beginning on January 1, 2020, credit losses are recognized through an allowance account subject to reversal, rather than a reduction in amortized cost. Declines in value attributable to factors other than credit are reported in other comprehensive income while the allowance for credit loss is charged to “realized and unrealized gains (losses) on investments” in the Company’s consolidated statements of income.

For fixed maturity investments the Company intends to sell or for which it is more likely than not that the Company will be required to sell before an anticipated recovery in value, the full amount of the impairment is included in “realized and unrealized gains (losses) on investments” on the Company’s consolidated statements of income (loss). The new cost basis of the investment is the previous amortized cost basis less the impairment recognized in “realized and unrealized gains (losses) on investments.” The new cost basis is not adjusted for any subsequent recoveries in fair value.

The Company reports accrued investment income separately from available for sale fixed maturities, and has elected not to measure an allowance for credit losses for accrued investment income. Uncollectible accrued interest is written off when the Company determines that no additional interest payments will be received.

Reinsurance Recoverables

In the normal course of business, the Company’s subsidiaries cede a portion of their premium and losses through pro rata and excess of loss reinsurance agreements on a treaty or facultative basis. Reinsurance recoverables are recorded as assets, predicated on the reinsurers’ ability to meet their obligations under the reinsurance agreements. In certain instances, the Company obtains collateral, including letters of credit and trust accounts, to further reduce the credit exposure on its reinsurance recoverables. The Company reports its reinsurance recoverables net of an allowance for expected credit loss in the Company’s consolidated balance sheets. The allowance is based upon the Company’s ongoing review of amounts outstanding, the financial condition of its reinsurers, amounts and form of collateral obtained and other relevant factors. A ratings based probability-of-default and loss-given-default methodology is used to estimate the allowance for expected credit loss. Any allowance for credit losses is charged to the Company’s consolidated statement of income

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(loss) in the period the recoverable is recorded and revised in subsequent periods to reflect changes in the Company's estimate of expected credit losses.

Premiums receivable and unearned premium reserves

Premiums are recognized as revenues pro rata over the policy period. Unearned premium reserves represent the unexpired portion of policy premiums. Accrued retrospective premiums are included in premiums receivable balances. Premiums receivable balances are reported net of an allowance for expected credit losses. The Company monitors credit risk associated with premiums receivable through its ongoing review of amounts outstanding, aging of the receivable, historical loss data and counterparty financial strength measures. The allowance also includes estimated uncollectible amounts related to dispute risk. Amounts deemed to be uncollectible, are written off against the allowance. In certain instances, credit risk may be reduced by the Company's right to offset loss obligations or unearned premiums against premiums receivable. Any allowance for credit losses is charged to the Company's consolidated statements of income (loss) in the period the receivable is recorded and revised in subsequent periods to reflect changes in the Company's estimate of expected credit losses.

Issued and effective as of March 31, 2020

In August 2018, the FASB issued ASU 2018-13, *Fair Value Measurement (Topic 820), Disclosure Framework - Changes to the Disclosure Requirements for Fair Value Measurements* ("ASU 2018-13"). ASU 2018-13 intends to modify the disclosure requirements on fair value measurements. This ASU was adopted on January 1, 2020, and the Company considers the impact to be immaterial to the Company's consolidated financial statements and disclosures.

In March 2020, the FASB issued ASU 2020-03, *Codification Improvements* ("ASU 2020-03"), which provide updates to a wide variety of Topics in the Codification. For public business entities, this ASU was effective upon issuance. This ASU was adopted upon issuance, and did not have a material impact on the Company's consolidated financial statements.

In April 2019, the FASB issued ASU 2019-04, which identified and clarified issues relevant to ASU 2017-12, *Derivatives and Hedging (Topic 815), Targeted Improvements to Accounting for Hedging Activities* ("ASU 2017-12"). For amendments related to ASU 2017-12, the effective date is as of the beginning of the first annual reporting period beginning after April 25, 2019. This ASU was adopted on January 1, 2020 and did not have a material impact on the Company's consolidated financial statements.

Recently issued accounting standards not yet adopted

In March 2020, the FASB issued ASU 2020-04, *Reference Rate Reform (Topic 848)*, ("ASU 2020-04"). This ASU provides practical expedients and exceptions for applying GAAP to contracts and transactions affected by reference rate reform if such contracts or transactions reference LIBOR or another reference rate expected to be discontinued. Amendments in this ASU for contract modifications may be applied as of March 12, 2020 through December 31, 2022. Once adopted, this ASU must be applied prospectively for all eligible contract modifications. The Company is currently assessing the impact the implementation of this ASU will have on its consolidated financial statements and disclosures, but does not believe that such impact will be material.

For additional information regarding accounting standards that the Company has not yet adopted, see Note 2, "Basis of presentation and significant accounting policies" in the Company's audited consolidated financial statements in Part II, Item 8 of the Company's Annual Report on Form 10-K for the year ending December 31, 2019.

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3. Segment information

The Company reports results under one segment, referred to as the “underwriting segment.” The underwriting segment captures the results of the Company’s underwriting lines of business, which are comprised of specialty products on a worldwide basis. Lines of business include: (i) casualty reinsurance; (ii) property catastrophe reinsurance; (iii) other specialty reinsurance; and (iv) insurance programs and coinsurance.

The accounting policies of the underwriting segment are the same as those used for the preparation of the Company’s consolidated financial statements.

The Company has a corporate function that includes certain general and administrative expenses related to corporate activities, interest expense (on its 6.5% senior notes due July 2, 2029), net foreign exchange gains (losses), income tax expense and items related to the Company’s preference shares.

The following table provides summary information regarding premiums written and earned by line of business and net premiums written by underwriting location:

	Three Months Ended March 31,	
	2020	2019
	<i>(\$ in thousands)</i>	
Gross premiums written:		
Casualty reinsurance	\$ 83,818	\$ 75,601
Other specialty reinsurance	36,880	24,298
Property catastrophe reinsurance	9,832	5,992
Insurance programs and coinsurance	104,372	80,798
Total	\$ 234,902	\$ 186,689
Net premiums written:		
Casualty reinsurance	\$ 83,667	\$ 75,065
Other specialty reinsurance	35,484	23,182
Property catastrophe reinsurance	9,832	5,982
Insurance programs and coinsurance	57,717	41,158
Total	\$ 186,700	\$ 145,387
Net premiums earned:		
Casualty reinsurance	\$ 52,765	\$ 63,313
Other specialty reinsurance	35,364	44,561
Property catastrophe reinsurance	4,884	2,971
Insurance programs and coinsurance	47,026	35,249
Total	\$ 140,039	\$ 146,094
Net premiums written by underwriting location:		
United States	\$ 36,303	\$ 18,402
Europe	21,203	23,258
Bermuda	129,194	103,727
Total	\$ 186,700	\$ 145,387

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4. Reinsurance

Through reinsurance agreements with Arch Reinsurance Ltd. (“ARL”) and Arch Reinsurance Company (“ARC”), which are subsidiaries of ACGL, as well as through other third-party reinsurance agreements, the Company cedes a portion of its premiums. The effects of reinsurance on the Company’s written and earned premiums, losses and loss adjustment expenses were as follows:

	Three Months Ended March 31,	
	2020	2019
<i>(\$ in thousands)</i>		
Premiums written		
Direct	\$ 104,372	\$ 80,798
Assumed	130,530	105,891
Ceded	(48,202)	(41,302)
Net	<u>\$ 186,700</u>	<u>\$ 145,387</u>
Premiums earned		
Direct	\$ 88,536	\$ 63,517
Assumed	99,529	113,481
Ceded	(48,026)	(30,904)
Net	<u>\$ 140,039</u>	<u>\$ 146,094</u>
Losses and loss adjustment expenses		
Direct	\$ 88,694	\$ 48,404
Assumed	74,720	84,524
Ceded	(52,738)	(22,078)
Net	<u>\$ 110,676</u>	<u>\$ 110,850</u>

The Company monitors the financial condition of its reinsurers and attempts to place coverages only with financially sound carriers. At March 31, 2020 and December 31, 2019, approximately 95% and 95%, respectively, were due from carriers which had an A.M. Best rating of “A-” or better, while 5% and 5%, respectively, were due from companies not rated.

At March 31, 2020 and December 31, 2019, approximately 45% and 47%, respectively, of the Company’s reinsurance recoverables on paid and unpaid losses (not including prepaid reinsurance premiums) were due from ARL and ARC, each of which have ratings of “A+” from A.M. Best. Although the Company has not experienced any material credit losses to date, an inability of its reinsurers to meet their obligations to it over the relevant exposure periods for any reason could have a material adverse effect on its financial condition and results of operations.

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5. Reserve for losses and loss adjustment expenses

The following table represents an analysis of losses and loss adjustment expenses and a reconciliation of the beginning and ending reserve for losses and loss adjustment expenses for the three months ended March 31, 2020 and 2019.

	Three Months Ended March 31,	
	2020	2019
	<i>(\$ in thousands)</i>	
Gross reserve for losses and loss adjustment expenses at beginning of period	\$ 1,263,628	\$ 1,032,760
Unpaid losses and loss adjustment expenses recoverable	165,549	81,267
Net reserve for losses and loss adjustment expenses at beginning of period	1,098,079	951,493
Net incurred losses and loss adjustment expenses relating to losses occurring in:		
Current period	110,856	110,901
Prior years	(180)	(51)
Total net losses and loss adjustment expenses	110,676	110,850
Foreign exchange (gains) losses	(26,015)	4,163
Net paid losses and loss adjustment expenses relating to losses occurring in:		
Current period	(10,585)	(6,330)
Prior years	(62,585)	(54,598)
Total paid losses and loss adjustment expenses	(73,170)	(60,928)
Net reserve for losses and loss adjustment expenses at end of period	1,109,570	1,005,578
Unpaid losses and loss adjustment expenses recoverable	190,679	98,954
Gross reserve for losses and loss adjustment expenses at end of period	\$ 1,300,249	\$ 1,104,532

During the three months ended March 31, 2020, the Company recorded net favorable development on prior year loss reserves of \$0.2 million. Net favorable development was experienced on casualty reinsurance losses of \$4.0 million, property catastrophe reinsurance losses of \$0.5 million, and other specialty reinsurance losses \$0.1 million, offset by unfavorable development on insurance losses of \$4.4 million.

During the three months ended March 31, 2019, the Company recorded net favorable development on prior year loss reserves of \$0.1 million. Net favorable development was experienced on casualty reinsurance losses of \$1.8 million, offset by unfavorable development on property catastrophe reinsurance losses of \$0.8 million, insurance programs and coinsurance losses of \$0.6 million, and other specialty reinsurance losses of \$0.4 million.

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6. Allowance for expected credit losses

Premiums Receivable

The following table presents the balances of premiums receivable, net of the allowance for expected credit losses, at January 1, 2020 and March 31, 2020 and changes in the allowance for expected credit losses for the three months ended March 31, 2020.

	Premiums Receivable, Net of Allowance	Allowance for Expected Credit Losses
	<i>(\$ in thousands)</i>	
Balance at beginning of period	\$ 273,657	\$ —
Cumulative effect of adoption of updated accounting guidance for credit losses at January 1, 2020		156
Current period change for expected credit losses		—
Write-offs charged against the allowance		—
Balance at end of period	\$ 281,541	\$ 156

Reinsurance Recoverables

The following table presents the balances of reinsurance recoverables, net of the allowance for expected credit losses, at January 1, 2020 and March 31, 2020, and changes in the allowance for expected credit losses for the three months ended March 31, 2020.

	Reinsurance Recoverables, Net of Allowance	Allowance for Expected Credit Losses
	<i>(\$ in thousands)</i>	
Balance at beginning of period	\$ 170,974	\$ —
Cumulative effect of adoption of updated accounting guidance for credit losses at January 1, 2020 (1)		297
Current period change for expected credit losses		—
Write-offs charged against the allowance		—
Balance at end of period	\$ 197,458	\$ 297

(1) The allowance for credit losses is gross of deferred tax of \$25 thousand.

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7. Investment information

Available for Sale Investments

The following tables summarize the fair value of the Company's securities classified as available for sale as of March 31, 2020 and December 31, 2019:

	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses (1)	Fair Value
<i>(\$ in thousands)</i>				
March 31, 2020				
Fixed maturities:				
U.S. government and government agency bonds	\$ 256,191	\$ 8,635	\$ —	\$ 264,826
Non-U.S. government and government agency bonds	151,000	4,040	(6,564)	148,476
Corporate bonds	169,735	2,296	(4,969)	167,062
Asset-backed securities	144,808	—	(31,225)	113,583
Mortgage-backed securities	26,341	—	(4,556)	21,785
Municipal government and government agency bonds	1,760	60	—	1,820
Total investments, available for sale	\$ 749,835	\$ 15,031	\$ (47,314)	\$ 717,552

(1) Effective January 1, 2020, the Company adopted ASU 2016-13, and as a result any credit impairment losses on the Company's available for sale securities are recorded as an allowance, subject to reversal. See Note 2, "Basis of presentation and significant accounting policies-(b) Recent accounting pronouncements-Issued and effective as of March 31, 2020 - Credit Losses" above for more information about ASU 2016-13. Included within the gross unrealized losses for corporate bonds is a credit allowance of \$0.6 million for securities with an unrealized loss of \$5.7 million as of March 31, 2020.

	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<i>(\$ in thousands)</i>				
December 31, 2019				
Fixed maturities:				
U.S. government and government agency bonds	\$ 282,076	\$ 1,708	\$ (137)	\$ 283,647
Corporate bonds	155,834	2,326	(41)	158,119
Asset-backed securities	145,555	614	(735)	145,434
Non-U.S. government and government agency bonds	129,456	3,530	(1,033)	131,953
Mortgage-backed securities	24,776	18	(44)	24,750
Municipal government and government agency bonds	1,759	46	—	1,805
Total investments, available for sale	\$ 739,456	\$ 8,242	\$ (1,990)	\$ 745,708

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The following table summarizes, for all available for sale securities in an unrealized loss position, the fair value and gross unrealized losses by length of time the security has been in a continual unrealized loss position:

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
March 31, 2020	<i>(\$ in thousands)</i>					
Fixed maturities:						
Non-U.S. government and government agency bonds	\$ 120,115	\$ (6,564)	\$ —	\$ —	\$ 120,115	\$ (6,564)
Corporate bonds	86,724	(4,969)	—	—	86,724	(4,969)
Asset-backed securities	100,514	(27,336)	13,069	(3,889)	113,583	(31,225)
Mortgage-backed securities	21,784	(4,556)	—	—	21,784	(4,556)
Total	\$ 329,137	\$ (43,425)	\$ 13,069	\$ (3,889)	\$ 342,206	\$ (47,314)
December 31, 2019						
Fixed maturities:						
U.S. government and government agency bonds	\$ 36,540	\$ (137)	\$ —	\$ —	\$ 36,540	\$ (137)
Non-U.S. government and government agency bonds	51,779	(1,027)	5,410	(6)	57,189	(1,033)
Corporate bonds	9,854	(41)	—	—	9,854	(41)
Asset-backed securities	55,194	(504)	19,430	(231)	74,624	(735)
Mortgage-backed securities	14,481	(44)	—	—	14,481	(44)
Total	\$ 167,848	\$ (1,753)	\$ 24,840	\$ (237)	\$ 192,688	\$ (1,990)

At March 31, 2020, 103 positions out of a total of 140 positions were in an unrealized loss position. The unrealized loss position increased during the three-month period from \$2.0 million to \$47.3 million. The decrease in value can be attributed to the market movements resulting from the COVID-19 global pandemic, which primarily impacted the asset-backed securities, and unfavorable foreign exchange rates impacting the non-U.S. government agency bonds during the period.

At December 31, 2019, 48 positions out of a total of 146 positions were in an unrealized loss position; however, the unrealized loss was less than 10% of the fair value for all 48 positions. The decrease in value can be attributed to movement in foreign exchange rates for the non-U.S. government agency bonds since purchase and the decrease in value for the asset-backed securities, primarily driven by market movements during the period. The Company believes that such securities were temporarily impaired at December 31, 2019.

Allowance for expected credit losses

The Company recognized an allowance for expected credit losses on available for sale securities of \$0.6 million for the three months ended March 31, 2020. No credit losses were previously recognized and there were no write-offs charged against the allowance. The allowance is recognized in “realized and unrealized gains (losses) on investments” in the Company’s consolidated statements of income (loss). There were no impairments of securities which the Company intends to sell or more likely than not will be required to sell.

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The amortized cost and fair value of our fixed maturities classified as available for sale, summarized by contractual maturity as of March 31, 2020 and December 31, 2019 are shown in the following tables.

	March 31, 2020		
	Amortized Cost	Estimated Fair Value	% of Fair Value
	<i>(\$ in thousands)</i>		
Due in one year or less	\$ 15,055	\$ 14,846	2.1%
Due after one year through five years	423,133	428,376	59.7%
Due after five years through ten years	127,826	127,555	17.8%
Due after ten years	12,672	11,407	1.6%
Asset-backed securities	144,808	113,583	15.8%
Mortgage-backed securities	26,341	21,785	3.0%
Total investments, available for sale	\$ 749,835	\$ 717,552	100.0%

	December 31, 2019		
	Amortized Cost	Estimated Fair Value	% of Fair Value
	<i>(\$ in thousands)</i>		
Due in one year or less	\$ 9,235	\$ 9,248	1.3%
Due after one year through five years	414,235	417,921	56.0%
Due after five years through ten years	133,822	136,329	18.3%
Due after ten years	11,833	12,026	1.6%
Asset-backed securities	145,555	145,434	19.5%
Mortgage-backed securities	24,776	24,750	3.3%
Total investments, available for sale	\$ 739,456	\$ 745,708	100.0%

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Fair Value Option and Fair Value Through Net Income

The following table summarizes the fair value of the Company's securities held as of March 31, 2020 and December 31, 2019, classified as fair value through net income or for which the fair value option was elected:

	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	<i>(\$ in thousands)</i>			
March 31, 2020				
Term loan investments	\$ 1,113,510	\$ 986	\$ (207,497)	\$ 906,999
Fixed maturities:				
Corporate bonds	296,918	4,038	(59,878)	241,078
U.S. government and government agency bonds	586	11	—	597
Asset-backed securities	198,262	2,231	(59,880)	140,613
Mortgage-backed securities	7,289	1,649	(409)	8,529
Non-U.S. government and government agency bonds	1,443	42	(103)	1,382
Municipal government and government agency bonds	252	1	—	253
Short-term investments	348,059	542	(4,740)	343,861
Other investments	28,673	2,009	—	30,682
Equities	53,111	12,130	(7,150)	58,091
Investments, fair value option	<u>\$ 2,048,103</u>	<u>\$ 23,639</u>	<u>\$ (339,657)</u>	<u>\$ 1,732,085</u>
Fair Value Through Net Income:				
Equities, fair value through net income	\$ 88,134	\$ 1,855	\$ (26,820)	\$ 63,169

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	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	<i>(\$ in thousands)</i>			
December 31, 2019				
Term loan investments	\$ 1,113,212	\$ 7,340	\$ (58,618)	\$ 1,061,934
Fixed maturities:				
Corporate bonds	221,024	8,430	(15,100)	214,354
U.S. government and government agency bonds	1,963	1	(2)	1,962
Asset-backed securities	200,361	3,329	(12,953)	190,737
Mortgage-backed securities	7,399	712	(405)	7,706
Non-U.S. government and government agency bonds	1,449	18	(11)	1,456
Municipal government and government agency bonds	380	—	(1)	379
Short-term investments	325,542	3,817	(56)	329,303
Other investments	28,672	2,264	(475)	30,461
Equities	54,893	10,690	(5,784)	59,799
Investments, fair value option	\$ 1,954,895	\$ 36,601	\$ (93,405)	\$ 1,898,091
Fair Value Through Net Income:				
Equities, fair value through net income	\$ 78,031	\$ 2,360	\$ (15,053)	\$ 65,338

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The amortized cost and fair value of our term loans, fixed maturities and short-term investments, excluding securities classified as available for sale, summarized by contractual maturity as of March 31, 2020 and December 31, 2019 are shown in the following tables.

	March 31, 2020		
	Amortized Cost	Estimated Fair Value	% of Fair Value
	<i>(\$ in thousands)</i>		
Due in one year or less	\$ 368,381	\$ 361,088	22.0%
Due after one year through five years	809,886	660,746	40.2%
Due after five years through ten years	582,501	472,336	28.7%
Asset-backed securities	198,262	140,613	8.6%
Mortgage-backed securities	7,289	8,529	0.5%
Total	\$ 1,966,319	\$ 1,643,312	100.0%

	December 31, 2019		
	Amortized Cost	Estimated Fair Value	% of Fair Value
	<i>(\$ in thousands)</i>		
Due in one year or less	\$ 368,452	\$ 370,479	20.5%
Due after one year through five years	779,643	742,960	41.1%
Due after five years through ten years	514,961	495,416	27.4%
Due after ten years	514	533	—%
Asset-backed securities	200,361	190,737	10.6%
Mortgage-backed securities	7,399	7,706	0.4%
Total	\$ 1,871,330	\$ 1,807,831	100.0%

Variable Interest Entities

In the normal course of its investing activities, the Company invests in limited partnerships, limited liability companies and other investment securities. Due to the legal forms of the entities and the fact that the investors lack the ability, through voting rights or similar rights, to make decisions that have a significant effect on the entities, such investments are considered variable interest entities. Since the Company lacks the ability to control the activities that most significantly impact the economic performance of these variable interest entities, the Company is not considered the primary beneficiary and does not consolidate these investments.

The activities of these entities are generally limited to holding and managing the underlying investments. The Company's maximum exposure to loss with respect to these investments is limited to the investment carrying amounts reported as "other investments" in the Company's consolidated balance sheet and any unfunded commitments. Realized and unrealized gains and losses from such investments are included in "realized and unrealized gains (losses) on investments" in the Company's consolidated statements of income (loss).

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The table below summarizes the credit quality of our total investments as of March 31, 2020 and December 31, 2019, as rated by Standard & Poor's Financial Services, LLC, or Standard & Poor's, Moody's Investors Service, or Moody's, Fitch Ratings Inc., or Fitch, Kroll Bond Rating Agency, or KBRA, or DBRS Morningstar, or DBRS, as applicable:

March 31, 2020	Credit Rating (1)											Not Rated
	Fair Value	AAA	AA	A	BBB	BB	B	CCC	CC	C	D	
	(\$ in thousands)											
Term loan investments	\$ 906,999	\$ —	\$ —	\$ —	\$ —	\$ 10,277	\$ 650,028	\$ 161,307	\$ 2,823	\$ 1,314	\$ 1,590	\$ 79,660
Fixed maturities:												
Corporate bonds	408,140	—	34,647	76,063	58,018	19,222	84,955	118,847	1,872	—	3,699	10,817
U.S. government and government agency bonds	265,423	—	265,423	—	—	—	—	—	—	—	—	—
Asset-backed securities	254,196	1,628	—	19,319	181,547	19,727	7,395	1,418	—	—	—	23,162
Mortgage-backed securities	30,314	—	—	4,600	17,185	1,190	—	—	—	—	2,552	4,787
Non-U.S. government and government agency bonds	149,858	—	149,858	—	—	—	—	—	—	—	—	—
Municipal government and government agency bonds	2,073	1,023	570	480	—	—	—	—	—	—	—	—
Total fixed income instruments	2,017,003	2,651	450,498	100,462	256,750	50,416	742,378	281,572	4,695	1,314	7,841	118,426
Short-term investments	343,861	30,174	154,787	402	110,795	—	40,000	—	—	—	—	7,703
Total fixed income instruments and short-term investments	2,360,864	32,825	605,285	100,864	367,545	50,416	782,378	281,572	4,695	1,314	7,841	126,129
Other Investments	30,682											
Equities	121,260											
Total	\$ 2,512,806	\$ 32,825	\$ 605,285	\$ 100,864	\$ 367,545	\$ 50,416	\$ 782,378	\$ 281,572	\$ 4,695	\$ 1,314	\$ 7,841	\$ 126,129

(1) For individual fixed maturity investments, Standard & Poor's ratings are used. In the absence of a Standard & Poor's rating, ratings from Moody's are used, followed by ratings from Fitch, followed by ratings from KBRA, followed by ratings from DBRS.

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December 31, 2019	Credit Rating (1)											
	Fair Value	AAA	AA	A	BBB	BB	B	CCC	CC	C	D	Not Rated
	(\$ in thousands)											
Term loan investments	\$1,061,934	\$ —	\$ —	\$ —	\$ —	\$ 9,617	\$761,168	\$215,909	\$ 6,823	\$ 2,119	\$ —	\$ 66,298
Fixed maturities:												
Corporate bonds	372,473	—	36,128	81,401	41,103	9,003	58,345	135,613	—	—	—	10,880
U.S. government and government agency bonds	285,609	—	285,609	—	—	—	—	—	—	—	—	—
Asset-backed securities	336,171	2,006	—	29,179	223,956	29,695	18,381	—	—	—	—	32,954
Mortgage-backed securities	32,456	—	—	1,100	23,650	976	—	—	—	—	2,497	4,233
Non-U.S. government and government agency bonds	133,409	—	132,460	—	949	—	—	—	—	—	—	—
Municipal government and government agency bonds	2,184	1,135	573	476	—	—	—	—	—	—	—	—
Total fixed income instruments	2,224,236	3,141	454,770	112,156	289,658	49,291	837,894	351,522	6,823	2,119	2,497	114,365
Short-term investments	329,303	25,783	136,842	34,903	115,155	—	—	8,359	—	—	—	8,261
Total fixed income instruments and short-term investments	2,553,539	28,924	591,612	147,059	404,813	49,291	837,894	359,881	6,823	2,119	2,497	122,626
Other Investments	30,461											
Equities	125,137											
Total	\$2,709,137	\$ 28,924	\$591,612	\$147,059	\$404,813	\$ 49,291	\$837,894	\$359,881	\$ 6,823	\$ 2,119	\$ 2,497	\$122,626

(1) For individual fixed maturity investments, Standard & Poor's ratings are used. In the absence of a Standard & Poor's rating, ratings from Moody's are used, followed by ratings from Fitch, followed by ratings from KBRA, followed by ratings from DBRS.

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Fair value option

The Company elected to carry the majority of fixed maturity securities and other investments at fair value under the fair value option afforded by accounting guidance regarding the fair value option for financial assets and liabilities. Changes in fair value of investments accounted for using the fair value option are included in “realized and unrealized gain (loss) on investments” in the Company’s consolidated statements of income (loss). The Company elected to use this option as investments are not necessarily held to maturity, and in order to address simplification and cost-benefit considerations.

Net investment income (loss)

The components of net investment income (loss) for the three months ended March 31, 2020 and 2019 were derived from the following sources:

	Three Months Ended March 31, 2020			
	Net Interest Income	Net Unrealized Gains (Losses)	Net Realized Gains (Losses)	Net Investment Income (Loss)
	<i>(\$ in thousands)</i>			
Net investment income (loss) by asset class:				
Term loan investments	\$ 21,018	\$ (155,233)	\$ (8,145)	\$ (142,360)
Fixed maturities - Fair value option	9,068	(89,675)	(1,244)	(81,851)
Fixed maturities - Available for sale (1)	4,660	—	2,180	6,840
Short-term investments	1,850	(3,440)	87	(1,503)
Equities (2)	—	76	1,041	1,117
Equities, fair value through net income (2)	377	(12,275)	(212)	(12,110)
Other investments	851	220	—	1,071
Other (3)	—	(25,129)	1,247	(23,882)
Investment management fees - related parties	(4,352)	—	—	(4,352)
Borrowing and miscellaneous other investment expenses	(5,669)	—	—	(5,669)
	<u>\$ 27,803</u>	<u>\$ (285,456)</u>	<u>\$ (5,046)</u>	<u>\$ (262,699)</u>

(1) Net realized gains (losses) from the fixed maturities available for sale portfolio consists of realized gains and realized losses of \$3.3 million and \$1.1 million, respectively. Realized losses include an allowance for expected credit losses on available for sale securities of \$0.6 million for the three months ended March 31, 2020.

(2) Net interest income includes dividends for securities held in long and short positions.

(3) Other includes unrealized gains and unrealized losses for total return swaps.

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	Three Months Ended March 31, 2019			
	Net Interest Income	Net Unrealized Gains (Losses)	Net Realized Gains (Losses)	Net Investment Income (Loss)
	(\$ in thousands)			
Net investment income (loss) by asset class:				
Term loan investments	\$ 22,410	\$ 9,366	\$ 64	\$ 31,840
Fixed maturities - Fair value option	16,043	19,975	(749)	35,269
Fixed maturities - Available for sale (1)	3,422	—	395	3,817
Short-term investments	524	(448)	—	76
Equities (2)	120	2,158	—	2,278
Equities, fair value through net income (2)	622	(1,989)	1,572	205
Other investments	—	1,794	—	1,794
Other (3)	—	1,582	—	1,582
Investment management fees - related parties	(4,409)	—	—	(4,409)
Borrowing and miscellaneous other investment expenses	(8,298)	—	—	(8,298)
Investment performance fees - related parties	—	—	—	(5,800)
	<u>\$ 30,434</u>	<u>\$ 32,438</u>	<u>\$ 1,282</u>	<u>\$ 58,354</u>

(1) Net realized gains (losses) from the fixed maturities available for sale portfolio consists of realized gains and realized losses of \$498.0 thousand and \$103.0 thousand, respectively.

(2) Net interest income includes dividends for securities held in long and short positions.

(3) Other includes unrealized gains and unrealized losses for total return swaps.

Pledged and restricted assets

For the benefit of certain Arch entities and other third parties that cede business to the Company, the Company is required to post and maintain collateral to support its potential obligations under reinsurance contracts written. This collateral can be in the form of either investment assets held in collateral trust accounts or letters of credit. Under its secured credit facilities, in order for the Company to have the bank issue a letter of credit to the Company's reinsurance contract counterparty, the Company must post investment assets or cash as collateral to the bank. In either case, the amounts remain restricted for the duration of the term of the trust or letter of credit, as applicable.

At March 31, 2020 and December 31, 2019, the Company held \$2.1 billion and \$2.1 billion, respectively, in pledged assets in support of insurance and reinsurance liabilities as well as to collateralize the Company's secured credit facilities and investment derivatives. Included within total pledged assets, the Company held \$5.1 million and \$6.4 million, respectively, in deposits with U.S. regulatory authorities.

Non-cash investing activities

During the first quarter of 2020, as a result of the restructuring of an investment position held by the Company, \$13.5 million of term loans, held within "term loans, fair value option," were exchanged for \$13.5 million of short-term investments held within "short-term investments, fair value option."

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During 2019, the Company exchanged a preference share position of \$28.7 million, which was held within “equity securities, fair value through net income,” for a limited partnership interest of \$28.7 million, held under “other investments, fair value option.” HPS acts as the general partner and manager of the limited partnership.

During 2019, as a result of the restructuring of an investment position held by the Company, \$16.9 million of term loans were converted to \$23.0 million of common and preferred stock held within “equity securities, fair value through net income,” along with cash funding from short-term investments of \$6.5 million.

8. Fair value

Fair value hierarchy

Accounting guidance regarding fair value measurements addresses how companies should measure fair value when they are required to use a fair value measure for recognition or disclosure purposes under GAAP and provides a common definition of fair value to be used throughout GAAP. It defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. In addition, it establishes a three-level valuation hierarchy for the disclosure of fair value measurements. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The level in the hierarchy within which a given fair value measurement falls is determined based on the lowest level input that is significant to the measurement (Level 1 being the highest priority and Level 3 being the lowest priority).

The levels in the hierarchy are defined as follows:

- *Level 1:* Inputs to the valuation methodology are observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets;
- *Level 2:* Inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument; and
- *Level 3:* Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The availability of observable inputs can vary by financial instrument and is affected by a wide variety of factors including, for example, the type of financial instrument, whether the financial instrument is new and not yet established in the marketplace, and other characteristics particular to the transaction. To the extent that valuation is based on models or inputs that are less observable or unobservable in the market, the determination of fair value requires significantly more judgment. The degree of judgment exercised by the Company in determining fair value is greatest for financial instruments categorized in Level 3. In periods of market dislocation, the observability of prices and inputs may be reduced for many financial instruments. This may lead to a change in the valuation techniques used to estimate the fair value measurement and cause an instrument to be reclassified between levels within the fair value hierarchy.

Fair value measurements on a recurring basis

The following is a description of the valuation methodologies used for securities measured at fair value, as well as the general classification of such securities pursuant to the valuation hierarchy.

The Company determines the existence of an active market based on its judgment as to whether transactions for the financial instrument occur in such market with sufficient frequency and volume to provide reliable pricing information. The independent pricing sources obtain market quotations and actual transaction prices for securities that have quoted prices in active markets. The Company uses quoted values and other data provided by nationally recognized independent pricing sources

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as inputs into its process for determining fair values of its fixed maturity investments. Each price source has its own proprietary method for determining the fair value of securities that are not actively traded. In general, these methods involve the use of “matrix pricing” in which the independent pricing source uses observable market inputs including, but not limited to, investment yields, credit risks and spreads, benchmarking of like securities, broker-dealer quotes, reported trades and sector groupings to determine a reasonable fair value.

Where multiple quotes or prices are obtained, a price source hierarchy is maintained in order to determine which price source would be used (*i.e.*, a price obtained from a pricing service with more seniority in the hierarchy will be used over a less senior one in all cases). The hierarchy prioritizes pricing services based on availability and reliability and assigns the highest priority to index providers. Based on the above review, the Company will challenge any prices for a security or portfolio which are considered not to be representative of fair value.

In certain circumstances, when fair values are unavailable from these independent pricing sources, quotes are obtained directly from broker-dealers who are active in the corresponding markets. Such quotes are subject to the validation procedures noted above. Where quotes are unavailable, fair value is determined by the Investment Manager using quantitative and qualitative assessments such as internally modeled values, which are reviewed by the Company’s management.

Of the \$2.5 billion of net financial assets and liabilities measured at fair value at March 31, 2020, approximately \$130.0 million, or 5.3%, were priced using non-binding broker-dealer quotes or modeled valuations. Of the \$2.6 billion of net financial assets and liabilities measured at fair value at December 31, 2019, approximately \$131.8 million, or 5.0%, were priced using non-binding broker-dealer quotes or modeled valuations.

The Company reviews its securities measured at fair value and discusses the proper classification of such investments with its Investment Managers and others. A discussion of the general classification of the Company’s financial instruments follows:

Fixed Maturities. The Company uses the market approach valuation technique to estimate the fair value of its fixed maturity securities, when possible. The market approach includes obtaining prices from independent pricing services, such as index providers and pricing vendors, as well as to a lesser extent quotes from broker-dealers. The independent pricing sources obtain market quotations and actual transaction prices for securities that have quoted prices in active markets. Each source has its own proprietary method for determining the fair value of securities that are not actively traded. In general, these methods involve the use of “matrix pricing” in which the independent pricing source uses observable market inputs including, but not limited to, investment yields, credit risks and spreads, benchmarking of like securities, broker-dealer quotes, reported trades and sector groupings to determine a reasonable fair value.

The following describes the significant inputs generally used to determine the fair value of the Company’s investment securities by asset class:

Term Loans. Fair values are estimated by using quoted prices obtained from independent pricing services for term loan investments with similar characteristics, pricing models or matrix pricing. Such investments are generally classified within Level 2. The fair values for certain of the Company’s term loans are determined by the Investment Manager using quantitative and qualitative assessments such as internally modeled values, which are reviewed by the Company’s management. The modeled values are based on peer loans and comparison to industry-specific market data. Significant unobservable inputs used to price these securities may include changes in peer and/or comparable credit spreads, accretion of any original issue discount and changes in the issuer’s debt leverage since issue. Changes in peer credit spreads, comparable credits spreads and issuer debt leverage are negatively correlated with the modeled fair value measurement. Such investments are generally classified within Level 3.

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Corporate Bonds. Valuations are provided by independent pricing services, substantially all through index providers and pricing vendors, with a small amount through broker-dealers. The fair values of these securities are generally determined using the spread above the risk-free yield curve. These spreads are generally obtained from the new issue market, secondary trading and from broker-dealers who trade in the relevant security market. As the significant inputs used in the pricing process for corporate bonds are observable market inputs, the fair value of the majority of these securities are classified within Level 2. The fair values for certain of the Company's corporate bonds are determined by the Investment Manager using quantitative and qualitative assessments such as internally modeled values, which are reviewed by the Company's management. The modeled values are based on peer bonds and comparison to industry-specific market data. In addition, the Investment Manager assesses the fair value based on the valuation of the underlying holdings in accordance with the bonds' governing documents. Significant unobservable inputs used to price these securities may include changes in peer and/or comparable credit spreads, accretion of any original issue discount and changes in the issuer's debt leverage since issue. Changes in peer credit spreads, comparable credits spreads, and issuer debt leverage are negatively correlated with the modeled fair value measurement. Such investments are generally classified within Level 3.

Asset-Backed Securities. Valuations are provided by independent pricing services, substantially all through index providers and pricing vendors, with a small amount through broker-dealers. The fair values of these securities are generally determined through the use of pricing models (including option adjusted spread) which use spreads to determine the appropriate average life of the securities. These spreads are generally obtained from the new issue market, secondary trading and from broker-dealers who trade in the relevant security market. The pricing services also review prepayment speeds and other indicators, when applicable. As the significant inputs used in the pricing process for asset-backed securities are observable market inputs, the fair value of these securities are classified within Level 2.

Mortgage-Backed Securities. Valuations are provided by independent pricing services, substantially all through pricing vendors and index providers with a small amount through broker-dealers. The fair values of these securities are generally determined through the use of pricing models (including option adjusted spread) which use spreads to determine the expected average life of the securities. These spreads are generally obtained from the new issue market, secondary trading and from broker-dealers who trade in the relevant security market. The pricing services also review prepayment speeds and other indicators, when applicable. As the significant inputs used in the pricing process for mortgage-backed securities are observable market inputs, the fair value of these securities are classified within Level 2.

U.S. Government and Government Agencies. Valuations are provided by independent pricing services, with all prices provided through index providers and pricing vendors. The Company determined that all U.S. Treasuries would be classified as Level 1 securities due to observed levels of trading activity, the high number of strongly correlated pricing quotes received on U.S. Treasuries and other factors. The fair values of U.S. government agency securities are generally determined using the spread above the risk-free yield curve. As the yields for the risk-free yield curve and the spreads for these securities are observable market inputs, the fair values of U.S. government agency securities are classified within Level 2.

Non-U.S. Government Securities. Valuations are provided by independent pricing services, with all prices provided through index providers and pricing vendors. The fair values of these securities are generally based on international indices or valuation models which include daily observed yield curves, cross-currency basis index spreads and country credit spreads. As the significant inputs used in the pricing process for non-U.S. government securities are observable market inputs, the fair value of these securities are classified within Level 2.

Municipal Government Bonds. Valuations are provided by independent pricing services, with all prices provided through index providers and pricing vendors. The fair values of these securities are

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generally determined using spreads obtained from broker-dealers who trade in the relevant security market, trade prices and the new issue market. As the significant inputs used in the pricing process for municipal bonds are observable market inputs, the fair value of these securities are classified within Level 2.

Short-Term Investments. The Company determined that certain of its short-term investments, held in highly liquid money market-type funds, and equities would be included in Level 1 as their fair values are based on quoted market prices in active markets. The fair values of other short-term investments are generally determined using the spread above the risk-free yield curve and are classified within Level 2.

Equity Securities. The Company determined that exchange-traded equity securities would be included in Level 1 as their values are based on quoted market prices in active markets. Other equity securities are initially valued at cost which approximates fair value. In subsequent measurement periods, the fair values of these securities are determined using non-binding broker-dealer quotes. These equity securities are included in Level 2 of the valuation hierarchy. Where such quotes are unavailable, fair value is determined by the Investment Manager using quantitative and qualitative assessments such as internally modeled values, which are reviewed by the Company's management. As the significant inputs used to price these securities are unobservable, the fair value of these securities are classified as Level 3. Significant unobservable inputs used to price preferred stock may include changes in peer and/or comparable credit spreads, accretion of any original issue discount and changes in the issuer's debt leverage since issue. Changes in peer credit spreads, comparable credit spreads and issuer debt leverage are negatively correlated with the modeled fair value measurement.

Underwriting Derivative Instruments. The Company values the government-sponsored enterprise credit-risk sharing transactions using a valuation methodology based on observable inputs from non-binding broker-dealer quotes and/or recent trading activity. As the inputs used in the valuation process are observable market inputs, the fair value of these securities are classified within Level 2. Refer to Note 9, "Derivative instruments" for more information.

Investment Derivative Instruments. The Company values the investment derivatives, including total return swaps and options, at fair value. As the underlying investments have observable inputs, the fair value of these securities are classified within Level 2. Refer to Note 9, "Derivative instruments" for more information.

Other Investments. The fair value of the Company's investments in private funds are measured using the most recently available net asset valuations, or NAVs, as advised by the third-party administrators.

Measuring the Fair Value of Other Investments Using Net Asset Valuations

The fair value of the Company's investments in private funds are measured using the most recently available NAVs as advised by the third-party administrators. The fund NAVs are based on the administrator's valuation of the underlying holdings in accordance with the fund's governing documents and in accordance with GAAP.

The Company often does not have access to financial information relating to the underlying securities held within the fund therefore management is unable to corroborate the fair values placed on the securities underlying the asset valuations provided by the fund manager or fund administrator. In order to assess the reasonableness of the NAVs, the Company performs a number of monitoring procedures on a quarterly basis, to assess the quality of the information provided by the fund manager and fund administrator. These procedures include, but are not limited to, regular review and discussion of the fund's performance with its manager.

The fair value of the private funds are measured using the NAVs as a practical expedient, therefore the fair value of the funds have not been categorized within the fair value hierarchy.

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The following table presents the Company's financial assets and liabilities measured at fair value by level as of March 31, 2020 and December 31, 2019:

March 31, 2020	Fair Value Measurement Using:			
	Estimated Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	<i>(\$ in thousands)</i>			
Assets measured at fair value:				
Term loans	\$ 906,999	\$ —	\$ 871,054	\$ 35,945
Fixed maturities:				
Corporate bonds	408,140	—	407,175	965
U.S. government and government agency bonds	265,423	265,310	113	—
Asset-backed securities	254,196	—	254,196	—
Mortgage-backed securities	30,314	—	30,314	—
Non-U.S. government and government agency bonds	149,858	—	149,858	—
Municipal government and government agency bonds	2,073	—	2,073	—
Short-term investments	343,861	296,158	47,703	—
Equities	121,260	9,750	1,420	110,090
Other investments measured at net asset value (1)	30,682	—	—	—
Total assets measured at fair value	\$ 2,512,806	\$ 571,218	\$ 1,763,906	\$ 147,000
Other underwriting derivative liabilities				
	\$ 314	\$ —	\$ 314	\$ —
Investment derivative liabilities (2)	23,726	—	23,726	—
Payable for securities sold short:				
Corporate bonds	30,076	—	30,076	—
Total liabilities measured at fair value	\$ 54,116	\$ —	\$ 54,116	\$ —

(1) In accordance with applicable accounting guidance, other investments that are measured at fair value using the net asset value practical expedient have not been classified in the fair value hierarchy. The fair value amounts presented in this table are intended to permit reconciliation of the fair value hierarchy to the amounts presented in the consolidated balance sheets.

(2) Investment derivative assets and liabilities represent the fair value of total return swaps, which are recorded in "other liabilities" in the consolidated balance sheets as of March 31, 2020.

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December 31, 2019	Fair Value Measurement Using:			
	Estimated Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	<i>(\$ in thousands)</i>			
Assets measured at fair value:				
Term loans	\$ 1,061,934	\$ —	\$ 1,025,886	\$ 36,048
Fixed maturities:				
Corporate bonds	372,473	—	371,540	933
U.S. government and government agency bonds	285,609	285,500	109	—
Asset-backed securities	336,171	—	336,171	—
Mortgage-backed securities	32,456	—	32,456	—
Non-U.S. government and government agency bonds	133,409	—	133,409	—
Municipal government and government agency bonds	2,184	—	2,184	—
Short-term investments	329,303	318,012	11,291	—
Equities	125,137	13,548	2,998	108,591
Other underwriting derivative assets	148	—	148	—
Investment derivative assets (1)	1,667	—	1,667	—
Other investments measured at net asset value (2)	30,461	—	—	—
Total assets measured at fair value	\$ 2,710,952	\$ 617,060	\$ 1,917,859	\$ 145,572
Investment derivative liabilities (1)	257	—	257	—
Payable for securities sold short:				
Corporate bonds	66,257	—	66,257	—
Total liabilities measured at fair value	\$ 66,514	\$ —	\$ 66,514	\$ —

(1) Investment derivative assets and liabilities represent the fair value of total return swaps, which are recorded in “other assets” and “other liabilities,” respectively, in the consolidated balance sheets as of December 31, 2019.

(2) In accordance with applicable accounting guidance, other investments that are measured at fair value using the net asset value practical expedient have not been classified in the fair value hierarchy. The fair value amounts presented in this table are intended to permit reconciliation of the fair value hierarchy to the amounts presented in the consolidated balance sheets.

When the fair value of financial assets and financial liabilities cannot be derived from active markets, the fair value is determined using a variety of valuation techniques that include the use of models. The inputs to these models are taken from observable markets where possible, but where this is not feasible, estimation is required to establish fair values. Changes in assumptions about these factors could affect the reported fair value of financial instruments and the level where the instruments are disclosed in the fair value hierarchy.

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The following table presents a reconciliation of the beginning and ending balances for all the financial assets measured at fair value on a recurring basis using Level 3 inputs for the three months ended March 31, 2020 and 2019:

Three Months Ended March 31, 2020	Beginning Balance	Net Purchases (Sales)(1)	Net Unrealized Gains (Losses)(2)	Net Unrealized Foreign Exchange Gains (Losses)	Ending Balance
Term loans	\$ 36,048	\$ (74)	\$ (29)	\$ —	\$ 35,945
Corporate bonds	933	32	—	—	965
Equities	108,591	3,277	(1,778)	—	110,090
Total	\$ 145,572	\$ 3,235	\$ (1,807)	\$ —	\$ 147,000

Three Months Ended March 31, 2019	Beginning Balance	Transfers in (out) of Level 3 (3)	Net Purchases (Sales) (1)	Net Unrealized Gains (Losses)(2)	Net Unrealized Foreign Exchange Gains (Losses)	Ending Balance
Term loans	\$ 47,479	\$ —	\$ 163	\$ (274)	\$ —	\$ 47,368
Corporate bonds	24,277	—	(90)	(69)	(399)	23,719
Asset-backed securities	22,560	(22,560)	—	—	—	—
Equities	70,451	—	30,534	(334)	—	100,651
Total	\$ 164,767	\$ (22,560)	\$ 30,607	\$ (677)	\$ (399)	\$ 171,738

(1) For the three months ended March 31, 2020, the net purchases (sales) consisted of purchases of \$3.3 million of equities and \$32.0 thousand of corporate bonds, partially offset by calls and redemptions of \$74.0 thousand of term loans. For the three months ended March 31, 2019, the net purchases (sales) consisted of purchases of \$37.8 million of equities and \$237.0 thousand of term loans, offset in part by sales, calls and redemptions of \$7.3 million of equities, \$89.9 thousand of corporate bonds and \$74.0 thousand of term loans.

(2) Realized and unrealized gains or losses on Level 3 investments are included in “realized and unrealized gain (loss) on investments” in the Company’s consolidated statements of income (loss).

(3) During the three months ended March 31, 2019, the Company obtained pricing for an asset-backed security, for which pricing was not available as of December 31, 2018. As such, the security was transferred from Level 3 to Level 2 at its fair value as of December 31, 2018.

Financial instruments disclosed, but not carried, at fair value

The Company uses various financial instruments in the normal course of its business. The carrying values of cash and cash equivalents, accrued investment income, receivable for securities sold, certain other assets, payable for securities purchased and certain other liabilities approximated their fair values at March 31, 2020 and December 31, 2019 due to their respective short maturities. As these financial instruments are not actively traded, their respective fair values are classified within Level 2.

On July 2, 2019, the Company completed a private offering of \$175.0 million in aggregate principal amount of its 6.5% senior notes due July 2, 2029 (the “senior notes”). At March 31, 2020, the Company’s senior notes were carried at cost, net of debt issuance costs, of \$172.5 million and had a fair value of \$167.2 million. The fair value of the senior notes was obtained from a third party pricing service and was based on observable market inputs. As such, the fair values of the senior notes are classified within Level 2.

Fair value measurements on a non-recurring basis

The Company measures the fair value of certain assets on a non-recurring basis, generally quarterly, annually, or when events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. The Company uses a variety of techniques to determine the fair value of these assets when appropriate, as described below.

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Intangible Assets

The Company tests intangible assets for impairment whenever events or changes in circumstances indicate the carrying amount may not be recoverable. When the Company determines intangible assets may be impaired, the Company uses techniques including discounted expected future cash flows, to measure fair value. There were no such triggering events or changes in circumstances as of March 31, 2020. There were no additional assets measured at fair value on a non-recurring basis as of March 31, 2020 and December 31, 2019.

9. Derivative instruments

Underwriting Derivatives

The Company's underwriting strategy allows it to enter into government-sponsored enterprise credit-risk sharing transactions. These transactions are accounted for as derivatives. The derivative assets and derivative liabilities relating to these transactions are included in "other assets" and "other liabilities," respectively, in the Company's consolidated balance sheets. Realized and unrealized gains and losses from other derivatives are included in "other underwriting income (loss)" in the Company's consolidated statements of net income (loss). The risk in force of these transactions is considered the notional amount.

As of March 31, 2020 and December 31, 2019, the Company posted \$12.5 million and \$13.1 million, respectively, in assets as collateral. These assets are included in "fixed maturities," which are recorded at fair value in the Company's consolidated balance sheets.

Investment Derivatives

The Company's investment strategy allows for the use of derivative securities. The Company invests in call options to manage specific market risks; such derivative instruments are recorded at fair value, and shown as part of "payable for securities sold short" on its consolidated balance sheets. Such call options were purchased and sold in the first quarter of 2020.

Additionally, beginning in the fourth quarter of 2018, the Company invested in put options to manage specific market risks; such derivative instruments are recorded at fair value, and shown as part of "equity securities" on its consolidated balance sheets. Such put options were sold in the first quarter of 2019.

The Company began investing in total return swaps ("swaps") during 2018, through a Master Confirmation of Total Return Swap Transactions agreement, and recognizes the swap derivatives at fair value. The derivative assets and derivative liabilities relating to these transactions are included in "other assets" and "other liabilities," respectively, in the Company's consolidated balance sheets. At March 31, 2020 and December 31, 2019, the Company had collateral funds held by the counterparty of \$62.1 million and \$64.1 million included in "short-term investments" in the Company's consolidated balance sheets.

The fair value of such swaps are based on observable inputs and classified in Level 2 of the valuation hierarchy. Realized and unrealized gains and losses from investment derivatives are included in "realized and unrealized gains (losses)" on investments in the Company's consolidated statements of net income (loss).

The Company did not hold any derivatives designated as hedging instruments at March 31, 2020 and December 31, 2019.

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The following table summarizes information on the fair values and notional amount of the Company's derivative instruments at March 31, 2020 and December 31, 2019:

	Estimated Fair Value			Notional Amount (1)
	Asset Derivatives	Liability Derivatives	Net Derivatives	
	<i>(\$ in thousands)</i>			
March 31, 2020				
Other underwriting derivatives	\$ —	\$ 314	\$ (314)	\$ 56,923
Total return swaps	—	23,726	(23,726)	112,745
Total	\$ —	\$ 24,040	\$ (24,040)	\$ 169,668
December 31, 2019				
Other underwriting derivatives	\$ 148	\$ —	\$ 148	\$ 59,879
Total return swaps	1,667	257	1,410	162,678
Total	\$ 1,815	\$ 257	\$ 1,558	\$ 222,557

(1) The notional amount represents the absolute value of all outstanding contracts.

The realized and unrealized gains and losses on the Company's derivative instruments are reflected in the consolidated statements of income, as summarized in the following table:

	Three Months Ended March 31,	
	2020	2019
	<i>(\$ in thousands)</i>	
Underwriting derivatives:		
Other underwriting income (loss)	\$ 133	\$ 592
Investment derivatives:		
Net realized and unrealized gains (losses):		
Options	1,081	801
Total return swaps	(23,882)	1,582

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10. Earnings per common share

The following table sets forth the computation of basic and diluted earnings per common share:

	Three Months Ended March 31,	
	2020	2019
	<i>(\$ in thousands except share and per share data)</i>	
Numerator:		
Net income (loss) before preference dividends	\$ (266,608)	\$ 52,539
Preference dividends	(1,171)	(4,907)
Net income (loss) available to common shareholders	(267,779)	47,632
Denominator:		
Weighted average common shares outstanding - basic and diluted (1)(2)	19,951,932	22,682,875
Earnings (loss) per common share:		
Basic and diluted	\$ (13.42)	\$ 2.10

(1) During the three months ended March 31, 2020, the Company granted an aggregate of 63,591 restricted share units and common shares to certain employees and directors, 48,916 of which are non-vested. During the three months ended March 31, 2019, the Company did not grant any restricted share units or common shares. The weighted average non-vested restricted share units of 13,727 are excluded from the calculation of diluted weighted average common shares outstanding for the three months ended March 31, 2020, due to a net loss reported. Refer to Note 17, "Share transactions" for further details.

(2) Warrants held by Arch and HPS were not included in the computation of diluted earnings because the exercise price of the warrants exceeded the market price of the common shares during the period and the exercise of the warrants would have been anti-dilutive. The warrants expired on March 25, 2020. The number of common shares issuable upon exercise of the warrants that was excluded was 1,704,691 common shares.

11. Income taxes

Watford Holdings and Watford Re are incorporated under the laws of Bermuda and, under current law, are not obligated to pay any taxes in Bermuda based upon income or capital gains. In the event that any legislation is enacted in Bermuda imposing such taxes, a written undertaking has been received from the Bermuda Minister of Finance under the Exempted Undertakings Tax Protection Act 1966 that such taxes will not be applicable to Watford Holdings and Watford Re until March 31, 2035.

WICE is incorporated under the laws of Gibraltar and regulated by the Gibraltar Financial Services Commission (the "FSC") under the Financial Services (Insurance Company) Act (the "Gibraltar Act"). In addition to its operations in Gibraltar, WICE operates a branch in Romania. The current rates of tax on applicable profits in Gibraltar and Romania are 10% and 16%, respectively. The open tax years that are potentially subject to examination are 2018 through 2020 in Gibraltar and 2018 through 2020 in Romania.

Watford Holdings (U.K.) Limited is incorporated in the United Kingdom and is subject to U.K. corporate income tax. The current U.K. corporate income tax rate is 19% and will be reduced to 17% from April 1, 2020. The open tax years that are potentially subject to examination by U.K. tax authorities are 2018 through 2020.

Watford Holdings (U.S.) Inc. is incorporated in the United States and files a consolidated U.S. federal tax return with its subsidiaries, WSIC, WIC and Watford Services Inc. The U.S. federal tax rate is 21% for tax years beginning after December 31, 2017. The open tax years that are potentially subject to examination by U.S. tax authorities are 2016 through 2020.

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The Company provides a valuation allowance to reduce certain deferred tax assets to an amount which management expects to more likely than not be realized. As of March 31, 2020 and December 31, 2019, the Company's valuation allowance was \$1.5 million and \$1.3 million, respectively. The valuation allowance includes U.S. operating loss carry-forwards that begin to expire in 2037. After consideration of the valuation allowance, the Company had net deferred tax assets of \$Nil as of March 31, 2020 and December 31, 2019.

After taking into account the impact of the change in the valuation allowance, the Company recognized income tax expense of \$Nil during the three months ended March 31, 2020 and 2019.

The Company recognizes a tax benefit where it concludes that it is more likely than not that the tax benefit will be sustained on audit by the taxing authority based solely on the technical merits of the associated tax position. The Company records interest and penalties related to unrecognized tax benefits in the provision for income taxes. As of both March 31, 2020 and December 31, 2019, the Company's total unrecognized tax benefits, including interest and penalties, were \$Nil.

12. Transactions with related parties

In March 2014, ARL invested \$100.0 million in the Company and acquired approximately 11% of its common equity.

AUL acts as the insurance and reinsurance manager for Watford Re and WICE while AUI acts as the insurance and reinsurance manager for WSIC and WIC, all under separate long-term services agreements. HPS manages the Company's non-investment grade portfolio and a portion of the Company's investment grade portfolio as investment manager and AIM manages a portion of the Company's investment grade portfolio as investment manager, each under separate long-term services agreements. ARL and HPS were granted warrants to purchase additional common equity based on performance criteria. In recognition of the sizable ownership interest, two senior executives of ACGL were appointed to the Company's board of directors. The services agreements with AUL and AUI and the investment management agreements with HPS and AIM provide for services for an extended period of time with limited termination rights by the Company. In addition, these agreements allow for AUL, AUI, HPS and AIM to participate in the favorable results of the Company in the form of performance fees.

ACGL and affiliates

At March 31, 2020, ARL held approximately 12.6% of the Company's common equity. Affiliates of ACGL held approximately 6.6% of the Company's preference shares.

On July 2, 2019, affiliates of ACGL purchased \$35 million in aggregate principal amount of the Company's 6.5% senior notes due July 2, 2029. On August 1, 2019, affiliates of ACGL received \$11.5 million in connection with the Company's redemption of its preference shares.

Certain directors, executive officers and management of ACGL own common and preference shares of the Company.

The related balances presented in the consolidated statement of income (loss) for the three months ended March 31, 2020 and 2019 were as follows:

	Three Months Ended March 31,	
	2020	2019
	(\$ in thousands)	
Consolidated statement of income (loss) items:		
Interest expense	\$ 582	\$ —
Preference dividends	78	325

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AUL and AUI

Watford Re and WICE entered into services agreements with AUL. WSIC and WIC entered into services agreements with AUI. AUL and AUI provide services related to the management of the underwriting portfolio for a term ending on December 2025. The services agreements perpetually renew automatically in five-year increments unless either the Company or Arch gives notice to not renew at least 24 months before the end of the then-current term.

As part of the services agreements, AUL and AUI make available to the Companies, on a non-exclusive basis, certain designated employees who serve as officers of the Companies and underwrite business on behalf of the Companies (the “Designated Employees”). AUL and AUI also provide portfolio management, Designated Employee supervision, exposure modeling, loss reserve recommendations, claims-handling, accounting and other related services as part of the services agreements.

In return for their services, AUL and AUI receive fees from the Companies, including an underwriting fee and profit commission, as well as reimbursement for the services of the Designated Employees and reimbursements for an allocated portion of the expenses related to seconded employees, plus other expenses incurred on behalf of the Company.

The related AUL and AUI fees and reimbursements incurred in the consolidated statement of income (loss) for the three months ended March 31, 2020 and 2019 were as follows:

	Three Months Ended March 31,	
	2020	2019
	(\$ in thousands)	
Consolidated statement of income (loss) items:		
Acquisition expenses	\$ 6,563	\$ 4,948
General and administrative expenses	988	2,011
Total	\$ 7,551	\$ 6,959

Reinsurance transactions with ACGL affiliates

The Company reinsures ARL and other ACGL subsidiaries and affiliates for property and casualty risks on a quota share basis. ACGL cedes business to the Company pursuant to inward retrocession agreements the Company’s operating subsidiaries have entered into with ACGL. Pursuant to these inward retrocession agreements, the Company pays a ceding fee based on the business ceded and the terms of the applicable retrocession agreement. Such fees, in addition to origination fees, are reflected in “acquisition expenses” on the Company’s consolidated statement of income (loss).

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The related consolidated statement of income (loss) for the three months ended March 31, 2020 and 2019 were as follows:

	Three Months Ended March 31,	
	2020	2019
	<i>(\$ in thousands)</i>	
Consolidated statement of income (loss) items:		
Gross premiums written	\$ 81,348	\$ 72,005
Net premiums earned	58,785	61,838
Loss and loss adjustment expenses	46,541	45,370
Acquisition expenses (1)	13,853	19,915

(1) Acquisition expenses relating to the ACGL inward quota share agreements referred to above. For the three months ended March 31, 2020 and 2019, the Company incurred ceding fees to Arch, in aggregate, of \$4.0 million and \$4.2 million, respectively, under these inward retrocession agreements.

Separately, the Company's operating subsidiaries have entered into outward quota share retrocession or reinsurance agreements with ACGL subsidiaries. Specifically, each of Watford Re and WICE has entered into a separate outward quota share retrocession or reinsurance agreement with ARL, and each of WSIC and WIC has entered into a separate outward quota share reinsurance agreement with ARC.

The related consolidated statement of income (loss) for the three months ended March 31, 2020 and 2019 for the outward retrocession transactions were as follows:

	Three Months Ended March 31,	
	2020	2019
	<i>(\$ in thousands)</i>	
Consolidated statement of income (loss) items:		
Gross premiums ceded	\$ (19,828)	\$ (16,990)
Net premiums earned	(19,788)	(12,940)
Loss and loss adjustment expenses	(15,815)	(9,138)
Acquisition expenses (1)	(4,537)	(3,104)

(1) Acquisition expenses relating to the ACGL outward quota share agreements referred to above.

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The related consolidated balance sheet account balances as of March 31, 2020 and December 31, 2019 were as follows:

	March 31, 2020	December 31, 2019
	(\$ in thousands)	
Consolidated balance sheet items:		
Total investments	\$ 680,448	\$ 815,528
Premiums receivable	122,147	106,462
Reinsurance recoverable on unpaid and paid losses and loss adjustment expenses	88,179	79,597
Prepaid reinsurance premiums	74,696	75,249
Deferred acquisition costs, net	34,760	31,609
Funds held by reinsurers	26,964	29,867
Reserve for losses and loss adjustment expenses	684,802	693,861
Unearned premiums	160,328	143,852
Losses payable	32,146	39,619
Reinsurance balances payable	58,604	62,301
Senior notes	34,497	34,484
Amounts due to affiliates	32,146	4,467
Other liabilities - contingent commissions	3,911	5,516
Contingently redeemable preference shares	3,463	3,462

AIM

Watford Re, WSIC, WICE and WIC entered into investment management agreements with AIM pursuant to which AIM manages a portion of our investment grade portfolio. Each of the Watford Re, WICE, WSIC and WIC investment management agreements with AIM has a one-year term, with the terms ending annually on March 31, July 31, January 31 and July 31, respectively. The terms will continue to renew for successive one-year periods; provided, however, that either party may terminate any of the investment management agreements with AIM at any time upon 45 days prior written notice. To date, there has been no such notice filed under such agreements.

In return for its investment management services, AIM receives a monthly management fee. The management fee is based on a percentage of the aggregate asset value of the AIM managed portfolio. For the purposes of calculating the management fees, asset value is determined by AIM in accordance with the investment management agreements and is measured before deduction of any management fees or expense reimbursement. The Company has also agreed to reimburse AIM for additional services related to investment consulting and oversight services, administrative operations and risk analytic support services related to the management of the Company's portfolio, as set forth in the investment management agreements.

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The related consolidated statement of income (loss) for the three months ended March 31, 2020 and 2019 were as follows:

	Three Months Ended March 31,	
	2020	2019
	(\$ in thousands)	
Consolidated statement of income (loss) items:		
Investment management fees - related parties	\$ 253	\$ 262

HPS

Certain HPS principals and management own common and preference shares of the Company.

In return for its investment services, HPS receives a management fee, a performance fee and allocated operating expenses. The management fee is calculated at an annual rate of 1.0% of the aggregate net asset value of the assets that are managed by HPS, payable quarterly in arrears. For purposes of calculating the management fees, net asset value is determined by HPS in accordance with the investment management agreements and is measured before reduction for any management fees, performance fees or any expense reimbursement and as adjusted for any non-routine intra-month withdrawals. The Company has also agreed to reimburse HPS for certain expenses related to the management of the Company's investment portfolios as set forth in the investment management agreements.

The base performance fee is equal to 10% of the Income (as defined in the investment management agreements relating to Watford Re, WICE and Watford Trust) or Aggregate Income (as defined in the investment management agreements relating to WSIC and WIC), as applicable, if any, on the assets managed by HPS, calculated and payable as of each fiscal year-end and the date on which the investment management agreements are terminated and not renewed, and HPS is eligible to earn an additional performance fee equal to 25% of any Excess Income (as defined in the investment management agreements) in excess of a net 10% return to Watford after deduction for paid and accrued management fees and base performance fees, with the total performance fees not to exceed 17.5% of the Income or Aggregate Income, as applicable. No performance fees will be paid to HPS if the high water mark (as described in the investment management agreements with HPS) is not met.

During 2017, the Company invested \$50.0 million in a private fund ("Master Fund") as part of HPS's investment strategy. HPS acts as the Trading Manager and provides certain administrative management services to the Master Fund. During 2019, the Company fully redeemed its investment in the Master Fund.

During 2019, the Company invested \$28.7 million in a limited partnership as part of HPS's investment strategy. HPS acts as the general partner and manager of the limited partnership. At March 31, 2020, the Company's investment had a fair value of \$30.7 million and represented approximately 12% of the outstanding partnership interests. The management fees and performance fees on the limited partnership will be subject to the existing fee structure of the existing investment management agreement between the Company and HPS, as discussed above.

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The related consolidated statement of income (loss) for the three months ended March 31, 2020 and 2019, and consolidated balance sheet account balances for HPS management fees and performance fees as of March 31, 2020 and December 31, 2019 were as follows:

	Three Months Ended March 31,	
	2020	2019
	(\$ in thousands)	
Consolidated statement of income (loss) items:		
Investment management fees - related parties	\$ 4,099	\$ 4,147
Investment performance fees - related parties	—	5,800
	\$ 4,099	\$ 9,947

	March 31,	December 31,
	2020	2019
	(\$ in thousands)	
Consolidated balance sheet items:		
Other investments, at fair value	\$ 30,682	\$ 30,461
Investment management and performance fees payable	5,428	17,762

Artex

In 2015, WICE and AUL entered into an insurance management services agreement with Artex Risk Solutions (Gibraltar) Limited, or Artex, pursuant to which Artex provides services to WICE relating to management, secretarial, governance, underwriting, claims, reinsurance, financial management, investment, regulatory, compliance, risk management and Solvency II. In addition, two principals of Artex have been appointed directors of WICE. In exchange for these services, the Company pays Artex fees based on WICE's gross premiums written, subject to a minimum amount of £150,000 per annum and a maximum amount of £400,000 per annum, in each case subject to an inflation increase on an annual basis. The insurance management services agreement may be terminated by either Artex or WICE upon twelve months prior written notice; provided that the agreement is subject to earlier termination by WICE or Artex upon the occurrence of certain events.

The table below provides the aggregate fees the Company paid to Artex under the insurance management services agreement for the three months ended March 31, 2020 and 2019.

	Three Months Ended March 31,	
	2020	2019
	(\$ in thousands)	
Fees paid to Artex under insurance management services agreement	\$ 86	\$ 131

For the three months ended March 31, 2020 and 2019, the Company paid no fees to Arch under this insurance management services agreement.

13. Commitments and contingencies

Concentrations of credit risk

For our reinsurance agreements, the creditworthiness of a counterparty is evaluated by the Company, taking into account credit ratings assigned by independent agencies. The credit approval process involves an assessment of factors, including, among others, the counterparty country and

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industry exposures. Collateral may be required, at the discretion of the Company, on certain transactions based on the creditworthiness of the counterparty.

The areas where significant concentrations of credit risk may exist include unpaid losses and loss adjustment expenses recoverable, prepaid reinsurance premiums and paid losses and loss adjustment expenses recoverable net of reinsurance balances payable (collectively, “net reinsurance recoverables”), investments and cash and cash equivalent balances.

The Company’s reinsurance recoverables, and prepaid reinsurance premiums, net of reinsurance balances payable, resulting from reinsurance agreements entered into with ARL and ARC as of March 31, 2020 and December 31, 2019 amounted to \$104.3 million and \$92.5 million, respectively. ARL and ARC have “A+” credit ratings from A.M. Best.

A credit exposure exists with respect to reinsurance recoverables as they may become uncollectible. The Company manages its credit risk in its reinsurance relationships by transacting with reinsurers that it considers financially sound and, if necessary, the Company may hold collateral in the form of funds, trust accounts and/or irrevocable letters of credit. This collateral can be drawn on for amounts that remain unpaid beyond specified time periods on an individual reinsurer basis.

In addition, the Company underwrites a significant amount of its business through brokers and a credit risk exists should any of these brokers be unable to fulfill their contractual obligations with respect to the payments of insurance and reinsurance balances owed to the Company.

The Company’s investment portfolios are managed in accordance with investment guidelines that include standards of diversification, which limit the allowable holdings of any single issuer. There were no investments in any entity in excess of 10% of the Company’s shareholders’ equity at March 31, 2020 and December 31, 2019, other than cash and cash equivalents held in operating and investment accounts with financial institutions with credit ratings between “A” and “AA-.”

Lloyds letter of credit facility

On May 14, 2019, Watford Re renewed its letter of credit facility with Lloyds Bank Corporate Markets Plc, New York Branch (the “Lloyds Facility”). The Lloyds Facility amount is \$100.0 million and was renewed through to May 16, 2020. Under the renewed Lloyds Facility, the Company may request an increase in the facility amount, up to an aggregate of \$50.0 million. The principal purpose of the Lloyds Facility is to issue, as required, evergreen standby letters of credit in favor of primary insurance or reinsurance counterparties with which the Company has entered into reinsurance arrangements to ensure that such counterparties are permitted to take credit for reinsurance obtained from the Company as required under insurance regulations in the United States. The amount of letters of credit issued is driven by, among other things, the timing and payment of catastrophe losses, loss development of existing reserves, the payment pattern of such reserves, the further expansion of the Company’s business and the loss experience of such business. When issued, the letters of credit are secured by certificates of deposit or cash. In addition, the Lloyds Facility also requires the maintenance of certain covenants, with which the Company was in compliance at March 31, 2020 and December 31, 2019. At such dates, the Company had \$48.7 million and \$51.0 million, respectively, in restricted assets as collateral for outstanding letters of credit issued from the Lloyds Facility, which were secured by certificates of deposit. These collateral amounts are reflected as short-term investments in the Company’s consolidated balance sheets.

Unsecured letter of credit facility

On September 20, 2019, Watford Re signed a 364-day letter of credit agreement with Lloyds Bank Corporate Markets Plc and BMO Capital Markets Corp. (the “Unsecured Facility”). The Unsecured Facility amount is \$100.0 million, and will be automatically extended for a period of one year unless canceled or not renewed by either counterparty prior to expiration. The principal purpose of the Unsecured Facility is to issue, as required, evergreen standby letters of credit in favor of primary insurance or reinsurance counterparties with which the Company has entered into reinsurance

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arrangements to ensure that such counterparties are permitted to take credit for reinsurance obtained from the Company as required under insurance regulations in the United States. The amount of letters of credit issued is driven by, among other things, the timing and payment of catastrophe losses, loss development of existing reserves, the payment pattern of such reserves, the further expansion of the Company's business and the loss experience of such business. The Unsecured Facility requires the maintenance of certain covenants, as well as certain representations and warranties that are customary for facilities of this type. At March 31, 2020 and December 31, 2019, the Company had \$25.2 million and \$19.3 million, respectively, in outstanding letters of credit issued from the Unsecured Facility, and was in compliance with the Unsecured Facility requirements.

Bank of America secured credit facility

On November 30, 2017, Watford Re amended and restated its \$800.0 million secured credit facility (the "Secured Facility") with Bank of America, N.A., which expires on November 30, 2021. The purpose of the Secured Facility is to provide borrowings, backed by Watford Re's investment portfolios. In addition, the Secured Facility allows for Watford Re to issue up to \$400.0 million in evergreen standby letters of credit in favor of primary insurance or reinsurance counterparties with which the Company has entered into reinsurance arrangements. At March 31, 2020, Watford Re had \$500.6 million and \$52.5 million in borrowings and outstanding letters of credit, respectively. At December 31, 2019, Watford Re had \$484.3 million and \$52.5 million in borrowings and outstanding letters of credit, respectively. At March 31, 2020 and December 31, 2019, Watford Re was in compliance with all covenants contained in the Secured Facility.

Custodian bank facility

As of March 31, 2020 and December 31, 2019, Watford Re had \$75.9 million and \$Nil, respectively, in borrowings from our custodian bank to purchase U.S. dollar denominated securities.

As of March 31, 2020, the total borrowed amount of \$75.9 million included 0.6 million Euros, or EUR, (U.S. dollar equivalent of \$0.7 million) to purchase EUR-denominated securities. The Company pays interest based on 3-month LIBOR plus a margin and the borrowed amount is payable upon demand. The foreign exchange gain or loss on revaluation on the non-U.S. dollar-denominated borrowed funds is included as a component of "net foreign exchange gains (losses)" included in the Company's consolidated statements of net income (loss).

The custodian bank requires the Company to hold cash and investments on deposit, or in an investment account with respect to the borrowed funds. At March 31, 2020 and December 31, 2019, the Company was required to hold \$108.2 million and \$Nil, respectively, in such deposits and investment accounts.

Employment and other arrangements

The Company has employment agreements with certain of its executive officers. Such employment arrangements provide for compensation in the form of base salary, annual bonus, participation in the Company's employee benefit programs, the Company's share-based compensation plans and the reimbursements of expenses.

Investment commitments

As of March 31, 2020, the Company had unfunded commitments of \$23.1 million relating to equities within its investment portfolios. As of December 31, 2019, the Company had unfunded commitments of \$8.4 million relating to term loans and \$26.4 million relating to equities within its investment portfolios.

Acquisition commitments

The Company has entered into an agreement to acquire Axeria IARD, a property and casualty insurance company based in France. The Company has committed to acquire 100% of the capital

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stock of Axeria IARD from the APRIL group. The completion of this transaction is subject to regulatory approval and other customary closing conditions, and is expected to close in the third quarter of 2020.

14. Leases

The Company has entered into a lease agreement for real estate that is used for office space in the ordinary course of business. The lease is accounted for as an operating lease, whereby the lease expense is recognized on a straight-line basis over the term of the lease.

The lease includes an option to extend or renew the lease term. The exercise of the renewal option is at the Company's discretion. The operating lease liability includes lease payments related to options to extend or renew the lease term if the Company is reasonably certain of exercising those options. Such options relating to the extension or renewal of the lease term are not included in the operating lease liability at this time.

Lease expense is included in "general and administrative expenses" in the Company's consolidated statements of net income (loss). Additional information regarding the Company's real estate operating lease is as follows.

	Three Months Ended March 31, 2020
	<i>(\$ in thousands)</i>
Lease cost:	
Operating lease	\$ 62
Other information on operating lease:	
Cash payments included in the measurement of lease liability reported in operating cash flows	71
Right-of-use assets (1)	908
Operating lease liability (2)	908
Weighted average discount rate	3.9%
Weighted average remaining lease term in years	3.5 years

(1) Included in "other assets" on the Company's consolidated balance sheet.

(2) Included in "other liabilities" on the Company's consolidated balance sheet.

The following tables present the contractual maturity of the Company's lease liability:

	March 31, 2020
	<i>(\$ in thousands)</i>
Remainder of 2020	212
2021	283
2022	283
2023	189
Total undiscounted lease payments	967
Less: present value adjustment	(59)
Operating lease liability	908

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15. Senior notes

On July 2, 2019, the Company completed a private offering of \$175.0 million in aggregate principal amount of its 6.5% senior notes due July 2, 2029. Interest on the senior notes is paid semi-annually in arrears on each January 2 and July 2, which commenced on January 2, 2020. The \$172.3 million net proceeds from the offering were used to redeem a portion of the Company's outstanding preference shares, as described in Note 16, "Contingently redeemable preference shares". Affiliates of ACGL purchased \$35 million in aggregate principal amount of the senior notes.

The senior notes are the Parent's senior unsecured and unsubordinated obligations and rank equally with all of the other existing and future obligations of the Parent that are unsecured and unsubordinated. The Company may redeem the senior notes at any time, in whole or in part, prior to July 2, 2024, at "make-whole" redemption price, subject to BMA requirements. After July 2, 2024, the senior notes are redeemable, in whole or in part, at a redemption price equal to 100% of the principal amount, subject to BMA requirements. The indenture governing the senior notes contains certain customary covenants, including those related to the punctual payment of interest and principal amounts due. The Company was in compliance with such covenants at March 31, 2020.

As of March 31, 2020, the carrying amount of the senior notes was \$172.5 million, presented net of unamortized debt issuance costs of \$2.5 million. As of December 31, 2019, the carrying amount of the senior notes was \$172.4 million, presented net of unamortized debt issuance costs of \$2.6 million.

16. Contingently redeemable preference shares

In March 2014, the Company issued 9,065,200 8½% Cumulative Redeemable Preference Shares (the "preference shares"). The preference shares have a par value of \$0.01 per share and a liquidation preference of \$25.00 per share. The preference shares were issued at a discounted purchase price of \$24.50 per share. Holders of the preference shares are entitled to receive, if declared by the board of directors, quarterly cash dividends on the last day of March, June, September and December of each year. Prior to June 30, 2019, dividends on the preference shares accrued at a fixed rate of 8.5% per annum (the "Fixed Rate Period"). Dividends accrue from (and including) June 30, 2019 (the "Floating Rate Period"), at a floating rate per annum (the "Floating Rate") equal to three-month U.S. dollar LIBOR *plus* a margin of 667.85 basis points; provided, that, if, at any time, the three-month U.S. dollar LIBOR shall be less than 1%, then the three-month U.S. dollar LIBOR for purposes of calculating the Floating Rate at the time of such calculation shall be 1%. The preference shares may be redeemed by the Company on or after June 30, 2019 or at the option of the preference shareholders at any time on or after June 30, 2034 at the liquidation price of \$25.00 per share. Because the redemption features are not solely within the control of the Company, the preference shares have been recorded as mezzanine equity on the Company's consolidated balance sheets in accordance with applicable accounting guidance. Preference share dividends, including the accretion of the discount and issuance costs, are included in "preference dividends" in the Company's consolidated statements of income (loss).

On August 1, 2019, the Company redeemed 6,919,998 of its 9,065,200 total issued and outstanding preference shares, which were redeemed at a total redemption price of \$25.19748 per share, inclusive of all declared and unpaid dividends, with accumulation of any undeclared dividends on or after June 30, 2019. After the redemption date, dividends on the preference shares that were redeemed ceased to accrue, and such redeemed preference shares ceased to be outstanding. Affiliates of Arch Capital Group Ltd. received \$11.5 million in connection with the redemption of the preference shares.

For the three months ended March 31, 2020 and 2019, dividends paid on the preference shares totaled \$1.1 million and \$4.9 million, respectively.

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The following table presents a reconciliation of the preference shares for the three months ended March 31, 2020 and 2019:

	Three Months Ended March 31,	
	2020	2019
	(\$ in thousands)	
Preference shares:		
Balance at the beginning of the period	\$ 52,305	\$ 220,992
Accretion discount and issuance costs on remaining preference shares	23	91
Balance at the end of the period	\$ 52,328	\$ 221,083

17. Share transactions

Share-based compensation

The Company uses share-based compensation plans for officers, other employees and directors of the Parent and its subsidiaries to provide competitive compensation opportunities, to encourage long-term service, to recognize individual contributions and reward achievement of performance goals and to promote the creation of long-term value for shareholders by aligning the interests of such persons with those of shareholders.

The 2018 Stock Incentive Plan (the "2018 Plan") became effective as of March 28, 2019 following approval by the Board of Directors of the Company and the listing of the Company's common shares on the Nasdaq Global Select Market. The 2018 Plan provides for the issuance of restricted share units, performance units, restricted shares, performance shares, share options and share appreciation rights and other equity-based awards to the Company's employees and directors. The 2018 Plan authorizes the issuance of 907,315 common shares and will terminate on March 28, 2029. As of March 31, 2020, 678,437 shares were available for future issuance.

During the first quarter of 2020, the Company granted an aggregate of 63,591 restricted share units and common shares to certain officers, other employees and directors. On the grant date of March 1, 2020, the fair value of the restricted share units and common shares was approximately \$23.00 per share. Of the total restricted share units and common shares granted, 14,675 were vested and fully expensed, including 10,870 common shares issued. The remaining 48,916 restricted share units are being amortized over a three-year vesting period, being the requisite service period. There were no forfeitures or expired awards during the first quarter of 2020.

The effect of compensation cost arising from share-based payment awards on the Company's consolidated statement of income (loss), within "general and administrative expenses," for the three months ended March 31, 2020 and 2019, was \$0.6 million and \$Nil, respectively, including an accelerated expense recognition for retirement eligible employees.

Share repurchase program

In the first quarter of 2020, the board of directors of the Parent authorized the Company's investment in its common shares through a share repurchase program under which the Company may repurchase up to \$50 million of its outstanding common shares (the "current share repurchase program").

During the first quarter of 2020, the Company purchased 127,744 shares at an average price per share of \$22.42 under the current share repurchase program. As of March 31, 2020, approximately \$47.1 million of unused share repurchase capacity remained available under the current share repurchase program. Since the inception of the share repurchase programs in 2019, the Company

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has repurchased a total of 2.9 million shares. At March 31, 2020, the shares are held in treasury, at an aggregate cost of \$77.9 million (excluding transaction costs).

Repurchases under the current share repurchase program may be effected from time to time in open market or privately negotiated transactions. The timing and amount of repurchase transactions under this program will depend on a variety of factors, including market conditions and corporate and regulatory considerations. Repurchases of the Company's common shares in connection with the current share repurchase program and other share-based transactions are recorded at cost and result in a reduction of the Company's shareholders' equity in its consolidated balance sheets.

18. Legal proceedings

The Company, in common with the insurance industry in general, is subject to litigation and arbitration in the normal course of its business. As of March 31, 2020, the Company was not a party to any litigation or arbitration, which is expected by management to have a material adverse effect on the Company's results of operations or financial condition and liquidity.

Item 2. Management’s discussion and analysis of financial condition and results of operations

The following discussion and analysis of our financial condition and results of operations contains forward-looking statements, which involve inherent risks and uncertainties. All statements other than statements of historical fact are forward-looking statements. These statements are based on our current assessment of risks and uncertainties. Actual results may differ materially from those expressed or implied in these statements and, therefore, undue reliance should not be placed on them. Important factors that could cause actual events or results to differ materially from those indicated in such statements are discussed elsewhere in this report, including the sections entitled Part I “Financial information - Cautionary note regarding forward-looking statements” and Part II Item 1A “Risk factors.”

This discussion and analysis should be read in conjunction with our consolidated financial statements and notes thereto included in Part I Item 1 “Consolidated financial statements” of this report. Tabular amounts are in U.S. dollars in thousands, except share amounts, unless otherwise noted.

Overview

We are a global property and casualty, or P&C, insurance and reinsurance company with approximately \$788.9 million in capital as of March 31, 2020, comprised of \$172.5 million of senior notes, \$52.3 million of contingently redeemable preference shares and \$564.1 million of common shareholders’ equity. Through operations in Bermuda, the United States and Europe, we write insurance and reinsurance on a worldwide basis. Our objective is to deliver attractive returns to shareholders by combining disciplined underwriting with superior investment management. Our strategy combines a diversified, casualty-focused underwriting portfolio, accessed through our multi-year, renewable strategic underwriting management relationship with Arch, with a disciplined investment strategy comprised primarily of non-investment grade corporate credit assets, managed by HPS. In addition, we have a services arrangement with AIM and other investment managers to manage our investment grade portfolio.

While we are positioned to provide a full range of P&C lines, we focus on writing specialty lines of business. We believe that our experienced management team, our relationship with Arch and our strong capital base have enabled us to successfully compete and establish a meaningful presence in the insurance and reinsurance markets in which we participate.

We seek to generate an attractive return on average equity across the relevant insurance and investment cycles. We opportunistically seek to underwrite new lines that fit our return profile while maintaining a disciplined underwriting approach.

Current outlook

The outbreak of COVID-19 began significantly impacting the U.S. and global markets during the 2020 first quarter. We remain committed to the safety of our employees, including restricting travel and instituting an extensive work from home policy. These actions have helped prevent a major disruption to our operations or our ability to service our clients.

The impact of the COVID-19 global pandemic on the worldwide economy has changed some aspects of our outlook. There could be elevated claims activity in certain lines of business and growth in written premium may be harder to achieve in a recessionary economy. In spite of these challenges, we will continue to look for opportunities to find acceptable books of business to underwrite without sacrificing underwriting discipline and will continue to focus on writing medium to long tail business. The severity, duration and long-term impacts of the COVID-19 global pandemic are difficult to predict, but we remain committed to our clients and the markets we serve.

We believe that we are relatively less exposed to COVID-19 global pandemic-related underwriting losses than many industry peers. For example, we have either no, or de minimis, premium writings in life, accident and health, event cancellation, trade credit, travel or pandemic-specific coverages which are likely to correspond directly to COVID-19 global pandemic-related losses. With regard to the potential exposure to business interruption losses, we write a limited amount of commercial property business, which is consistent with our strategy to target longer duration lines of business.

We believe the casualty lines most likely to be adversely affected by COVID-19 are professional and medical malpractice liability. We have reduced our exposure to professional liability over the last few years, and do not write material amounts of medical malpractice premium at present.

We believe that mortgage insurance may potentially be affected. We write U.S. mortgage risk through a government-sponsored enterprise (or “GSE”) credit risk transfer programs and have some international mortgage exposure. Most of our exposure is for mortgages that were originated prior to 2018. Based upon an internal actuarial review, we have increased our loss provision to account for a potential increase in defaults in our mortgage insurance portfolio. This provision had a modest impact on our overall first quarter 2020 results.

In April 2020, we significantly reduced our exposure to U.S. mortgage risk by transferring part of that risk to other parties. This action bolstered our economic capital position at a time of significant macro-economic uncertainty. While the transferred business had been profitable, we believe this was a prudent and responsible course of action given the negative and uncertain economic outlook created by the pandemic.

On a brighter note, we believe the insurance and reinsurance market environment is showing signs of noticeable price improvement. Primary rates in most casualty lines, with the exception of workers compensation, continue to be strong, albeit, we believe, partly in response to higher perceived social inflation. Property catastrophe reinsurance rates are up meaningfully, retrocession capacity is shrinking, and ceding commissions have reduced modestly on some proportional casualty treaties. We believe the factors supporting a continued favorable pricing environment include the low interest rate environment, three consecutive years of significant multiple catastrophe events, and signs of weakness in the adequacy of prior period loss reserves for some industry participants.

Against this backdrop, we are selectively growing our business in areas that we believe present attractive opportunities and meet our risk and return criteria. In particular, we continue to see good growth opportunities in the insurance market. In particular, our insurance underwriting platforms in the United States saw strong growth in premiums in the first quarter of 2020 versus the comparable prior year quarter.

We also see opportunities on the reinsurance side in general liability, commercial auto liability and other casualty lines. Our current underwriting portfolio has concentrations in general liability, professional liability, multiline, workers compensation and motor product lines through reinsurance of third-party cedants and retrocessions from Arch.

Our outsourced business model

We have engaged Arch and HPS to perform certain services for us that are essential to the results of our operations, and have entered into long-term, renewable contracts with each in order to ensure continued access to these services. For our underwriting operations, Arch provides underwriting services including sourcing and evaluating underwriting opportunities as well as related services such as claims-handling, loss control, exposure management, portfolio management, modeling, statistical, actuarial and administrative support services, in each case, subject to our underwriting and operational guidelines and the oversight of our senior management and board of directors. With regard to our investments, HPS manages our non-investment grade portfolio while AIM manages the largest portion of our investment grade portfolio, in each case subject to compliance with our investment guidelines and the oversight of our senior management and board of directors.

We outsource these functions in order to cost-effectively leverage the respective expertise and strong market positions of our trusted partners. Through our association with Arch, we access Arch's worldwide platform on a variable cost basis, thus avoiding the fixed expense of maintaining a multi-line platform for our underwriting operations. Similarly, we believe that the terms of service and structure of the compensation we pay to HPS and AIM provide benefits to us both in terms of cost-effective access to the expertise required to execute our investment strategy and in aligning interests.

Natural catastrophe risk

While we are more casualty-focused and assume less catastrophe exposure than many of our peers, we do underwrite a limited amount of natural catastrophe risk in order to balance and diversify our underwriting portfolio. We carefully monitor our natural catastrophe risk globally for all perils and regions where we believe our underwriting portfolio might have significant exposure.

Limited operating history and comparability of results

We were incorporated in July 2013 and completed our initial funding and began underwriting business in the first quarter of 2014. Our initial underwriting activities focused on writing reinsurance. In 2015, we began our insurance business in connection with the establishment of our U.S. and European insurance platforms. As a result, we have a limited operating history and, given our underwriting and investment strategies, are exposed to volatility in our results of operations that may not be apparent from a review of our historical results. Period-to-period comparisons of our results of operations may not be meaningful. In addition, the amount of premiums written may vary from year to year and period to period as a result of any number of factors, including changes in market conditions and our view of the long-term profit potential of individual lines of business.

Financial measures and ratios

Our management and board of directors use financial indicators and ratios in evaluating our performance and measuring the overall growth in value generated for our common shareholders. The key financial measures that we believe are meaningful in analyzing our performance are: underwriting income (loss), combined ratio, adjusted underwriting income (loss), adjusted combined ratio, net interest income, net interest income yield on average net assets (including the non-investment grade portfolio and investment grade portfolio components thereof), net investment income (loss), net investment income return on average net assets, net investment income return on average total investments (excluding accrued investment income), (including the non-investment grade portfolio and investment grade portfolio components thereof), book value per diluted common share, growth in book value per diluted common share and return on average equity.

The table below shows the key performance indicators for the three months ended March 31, 2020 and 2019:

	Three Months Ended March 31,	
	2020	2019
	(\$ in thousands, except percentages and per share data)	
Key underwriting metrics:		
Underwriting income (loss)	\$ (6,143)	\$ (5,970)
Combined ratio	104.4 %	104.1%
Adjusted underwriting income (loss)	\$ (3,014)	\$ (3,415)
Adjusted combined ratio	102.2 %	102.3%
Key investment return metrics:		
Net interest income	\$ 27,803	\$ 30,434
Net interest income yield on average net assets (1)	1.4 %	1.5%
Non-investment grade portfolio (1)	1.7 %	1.9%
Investment grade portfolio (1)	0.5 %	0.6%
Net investment income (loss)	\$ (262,699)	\$ 58,354
Net investment income return on average net assets (1)	(13.0)%	2.8%
Non-investment grade portfolio (1)	(17.4)%	3.4%
Investment grade portfolio (1)	0.8 %	1.1%
Net investment income return on average total investments (excluding accrued investment income) (2)	(10.1)%	2.1%
Non-investment grade portfolio (2)	(14.9)%	2.7%
Investment grade portfolio (2)	0.8 %	1.1%
Key shareholders' value creation metrics:		
Book value per diluted common share (3)	\$ 28.21	\$ 41.52
Growth in book value per diluted share (3)	(35.1)%	5.9%
Annualized return on average equity (4)	N.M.	20.8%

N.M. Ratio is not meaningful.

(1) Net interest income yield on average net assets and net investment income return on average net assets are calculated by dividing net interest income, and net investment income (loss), respectively, by average net assets. Net assets is calculated as the sum of total investments, accrued investment income and receivables for securities sold, less revolving credit agreement borrowings, payable for securities purchased and payable for securities sold short. For the three-month period, average net assets is calculated using the averages of each quarterly period. However, for the investment grade portfolio component of these returns, the impact of the revolving credit agreement borrowings is not subtracted from net interest income, net investment income (loss), or the net assets calculation. The separate components of these returns (non-investment grade portfolio and investment grade portfolio) are non-U.S. GAAP financial measures. Refer to "Reconciliation of non-U.S. GAAP financial measures" for a reconciliation of these components of our net interest income yield on average net assets and net investment income return on average net assets.

(2) Net investment income return on average total investments (excluding accrued investment income) is calculated by dividing net investment income by average total investments. For the three-month period, average total investments is calculated using the averages of each quarterly period. However, for the investment grade portfolio component of these returns, the impact of revolving credit agreement borrowings is not subtracted from net investment income. The separate components of these returns (non-investment grade portfolio and investment grade portfolio) are non-U.S. GAAP financial measures. Refer to "Reconciliation of non-U.S. GAAP financial measures" for a reconciliation of these components of our net investment income return on average total investments (excluding accrued investment income).

(3) Book value per diluted common share is calculated by dividing total shareholders' equity by the number of diluted common shares outstanding at the end of each reporting period. Growth in book value per diluted common share is calculated as the percentage change in value of beginning and ending book value per diluted common share over the reporting period.

(4) Annualized return on average equity represents net income (loss) expressed as a percentage of average total shareholders' equity during the period. Annualized return on average equity for the three months ended March 31, 2019 is calculated by extrapolating the quarterly return on average equity over a twelve-month period. For the three-month period, the average total shareholders' equity is calculated as the average of the beginning and ending total shareholders' equity of each quarterly period. Due to the net realized and unrealized losses on investments, the annualized return on average equity calculation is not meaningful for the three months ended March 31, 2020. For the three months ended March 31, 2020 and 2019, the return on average equity was (37.3)% and 5.2%, respectively.

Underwriting income (loss)

Underwriting income (loss) is a non-U.S. GAAP financial measure. We define underwriting income (loss) as net premiums earned less loss and loss adjustment expenses, acquisition expenses and general and administrative expenses. Underwriting income (loss) is one of the ways we evaluate the performance of our underwriting segment, and does not include other underwriting income (loss), net investment income (loss), interest expense, net foreign exchange gains (losses), income tax expenses and preference dividends. Although these items are an integral part of our operations, with the exception of other underwriting income (loss), they are independent of the underwriting process and result, in large part, from general economic and financial market conditions. We include other underwriting income (loss) in our adjusted underwriting income (loss), as described in more detail below. See “-Reconciliation of non-U.S. GAAP financial measures” for a reconciliation of underwriting income to net income (loss) available to common shareholders.

Combined ratio

The combined ratio is calculated as the sum of loss and loss adjustment expenses, acquisition expenses and general and administrative expenses, divided by net premiums earned, or equivalently, as the sum of the loss ratio, acquisition expense ratio and general and administrative expense ratio. The combined ratio is a measure of underwriting profitability but does not include other underwriting income or net investment income earned on underwriting cash flows.

Adjusted underwriting income (loss)

Adjusted underwriting income (loss) is a non-U.S. GAAP financial measure. We define adjusted underwriting income (loss) as underwriting income (loss) plus other underwriting income (loss) less certain corporate expenses. Adjusted underwriting income (loss) is one of the ways we evaluate the performance of our underwriting segment. We include other underwriting income (loss), as our underwriting strategy allows us to enter into government-sponsored enterprise credit-risk sharing transactions. Certain corporate expenses are generally comprised of non-recurring costs of the holding company, such as costs associated with the initial setup of subsidiaries, as well as costs associated with the ongoing operations of the holding company such as compensation of certain executives. See “-Reconciliation of non-U.S. GAAP financial measures” for a reconciliation of adjusted underwriting income to net income (loss) available to common shareholders.

Adjusted combined ratio

Adjusted combined ratio is a non-U.S. GAAP financial measure. The adjusted combined ratio is calculated as the sum of loss and loss adjustment expenses, acquisition expenses and general and administrative expenses less certain corporate expenses, divided by the sum of net premiums earned and other underwriting income (loss). This ratio is a measure of our underwriting and operational profitability but does not include certain corporate expenses or net investment income earned on underwriting cash flows. Certain corporate expenses are generally comprised of non-recurring costs of the holding company, such as costs associated with the initial setup of subsidiaries, as well as costs associated with the ongoing operations of the holding company such as compensation of certain executives. See “-Reconciliation of non-U.S. GAAP financial measures” for a reconciliation of our adjusted combined ratio to our combined ratio.

Net interest income and net investment income (loss)

Net interest income and net investment income (loss) are important contributors to our financial results. These key investment metrics are impacted by the performance of our Investment Managers as well as the state of the overall financial markets.

Net interest income yield on average net assets

Net interest income yield on average net assets is calculated by dividing net interest income by average net assets. Net assets is calculated as the sum of total investments, accrued investment income and receivables for securities sold, less revolving credit agreement borrowings, payable for securities purchased and payable for securities sold short. Net interest income yield on average net assets is a key indicator by which we measure the performance of our Investment Managers.

Net investment income return on average net assets

Net investment income return on average net assets is calculated by dividing net investment income (loss) by average net assets. Net assets is calculated as the sum of total investments, accrued investment income and receivables for securities sold, less revolving credit agreement borrowings, payable for securities purchased and payable for securities sold short. Net investment income return on average net assets is a key indicator by which we measure the performance of our Investment Managers.

Net investment income return on average total investments (excluding accrued investment income)

Net investment income return on average total investments (excluding accrued investment income) is calculated by dividing net investment income (loss) by average total investments. Net investment income return on average total investments (excluding accrued investment income) is a key indicator by which we measure the performance of our Investment Managers.

Non-investment grade portfolio and investment grade portfolio components of certain of our investment metrics

In order to provide further detail regarding our key investment metrics, we also present the non-investment grade portfolio and investment grade portfolio components of our net interest income yield on average net assets, net investment income return on average net assets and net investment income return on average total investments (excluding accrued investment income). In the calculation of the investment grade portfolio component of our net interest income yield on average net assets and net investment income return on average net assets, the impact of the revolving credit agreement borrowings is not subtracted from net interest income, net investment income (loss) or the net assets calculation. The separate components of these returns are non-U.S. GAAP financial measures. See “-Reconciliation of non-U.S. GAAP financial measures” for a reconciliation of these components of our net interest income yield on average net assets, net investment income return on average net assets and net investment income return on average total investments (excluding accrued investment income).

Growth in book value per diluted common share

Book value per diluted common share is calculated by dividing total shareholders' equity by the number of diluted common shares outstanding at the end of each reporting period. We calculate growth in book value per diluted common share as the percentage change in value of beginning and ending book value per diluted share over the reporting period. Book value per diluted common share is impacted by, among other factors, our underwriting results, our investment returns and our share repurchase activity, which has an accretive or dilutive impact on book value per diluted common share depending on the purchase price.

We measure our long-term financial success by our ability to compound growth in book value per diluted common share at an attractive rate of return. We believe that long-term growth in book

value per diluted common share is the most comprehensive measure of our success because it includes all underwriting, operating and investing results.

Return on average equity

Return on average equity is net income (loss) expressed as a percentage of average total shareholders' equity during the period and is used to measure profitability. Our goal is to generate an attractive long-term return on our common shareholders' equity.

Comment on non-U.S. GAAP financial measures

Throughout this report, we present our operations in the way we believe will be the most meaningful and useful to investors, analysts, rating agencies and others who will use our financial information in evaluating the performance of our company. This presentation includes the use of underwriting income (loss), adjusted underwriting income (loss), adjusted combined ratio and the separate components of our investment returns (non-investment grade investment portfolio and investment grade investment portfolio). The presentation of these metrics constitutes non-U.S. GAAP financial measures as defined by applicable SEC rules. We believe that this presentation enables investors and other users of our financial information to analyze our performance in a manner similar to how management analyzes performance. We also believe that this presentation follows industry practice and, therefore, allows the equity analysts and certain rating agencies that follow us and the insurance industry as a whole, as well as other users of our financial information to compare our performance with our industry peer group. See “-Reconciliation of non-U.S. GAAP financial measures” for reconciliations of such measures to the most directly comparable U.S. GAAP financial measures, in accordance with applicable SEC rules.

Components of our results of operations

Revenues

We derive our revenues from two principal sources:

- premiums from our insurance and reinsurance lines of business; and
- income from investments.

Premiums from our insurance and reinsurance lines of business are directly related to the number, type, size and pricing of contracts we write. Premiums are earned over the contract period in proportion to the period of risk covered which is typically 12 to 24 months.

Income from our investments is comprised of interest income and net realized and unrealized gains (losses), less investment related expenses as described below.

Expenses

Our expenses consist primarily of the following:

- loss and loss adjustment expenses;
- acquisition expenses;
- general and administrative expenses;
- investment related expenses; and
- interest expense.

Loss and loss adjustment expenses are a function of the amount and type of contracts and policies we write and of the loss experience of the underlying coverage. Loss and loss adjustment expenses are based on an actuarial analysis of the estimated losses, including losses incurred during the

period and changes in estimates from prior periods. Depending on the nature of the contract, loss and loss adjustment expenses may be paid over a period of years.

Acquisition expenses consist primarily of brokerage fees, ceding commissions, premium taxes, underwriting fees payable to Arch under our services agreements and other direct expenses that relate to our contracts and policies and are presented net of commissions received from reinsurance we purchase. We amortize deferred acquisition expenses over the related contract term in the same proportion that the premiums are earned. Our acquisition expenses may also include profit commissions paid to our sources of business in the event of favorable underwriting experience.

General and administrative expenses consist of salaries and benefits and related costs, legal and accounting fees, travel and client entertainment, fees relating to our letter of credit facilities, information technology, occupancy, the cost of employees made available to us by Arch under the services agreements, and other general operating expenses.

Investment-related expenses primarily consist of management and performance fees we pay to our Investment Managers, as well as interest and other expenses on borrowings from our credit facilities when used to finance a portion of our investments. The fee structure that we pay to HPS related to our non-investment grade portfolio was reduced beginning on January 1, 2018. We currently pay a management fee to HPS related to its management of our non-investment grade portfolio on a quarterly basis equal to 1.0% of net assets. Beginning January 1, 2020, to the extent the aggregate net asset value of the HPS-managed non-investment grade portfolio assets exceeds \$1.5 billion, the management fee shall be calculated at a blended annual rate equal to (i) 1.0% of the initial \$1.5 billion in net asset value plus (ii) seventy-five basis points (0.75%) of the excess of aggregate net asset value over \$1.5 billion, subject to a minimum blended management fee rate of eighty-five basis points (0.85%) on the aggregate net asset value of the HPS-managed non-investment grade portfolio assets. In addition, on an annual basis, subject to then-applicable high water marks, HPS receives a base performance fee equal to 10% of the income generated on the non-investment grade portfolio, and is eligible to earn an additional performance fee equal to 25% of any such investment income in excess of a net 10% return to us after deduction for paid and accrued management fees and base performance fees, with the total performance fees not to exceed 17.5% of the Income (as defined in the investment management agreements relating to Watford Re, WICE and Watford Trust) or Aggregate Income (as defined in the investment management agreements relating to WSIC and WIC), as applicable.

We have also engaged HPS to manage a portion of our investment grade portfolio as a separate managed account. We pay HPS a management fee equal to 0.60% per annum on the assets in the separate managed account. We also pay AIM monthly asset management fees related to the assets it manages for us. We are not obligated to pay performance fees to any of the Investment Managers managing our investment grade portfolios. We include the HPS non-investment grade portfolio base management fee and the AIM investment grade portfolio management fee in “investment management fees - related parties” in our consolidated statement of income, and as management fees are accrued and paid to HPS in connection with its management of a portion of our investment grade portfolio, we will include such fees therein as well. We include interest and other expenses on borrowings in “borrowing and miscellaneous other investment expenses” in our consolidated statement of income. The HPS non-investment grade portfolio performance fee, if applicable, is shown on a separate line in our consolidated statement of income.

Interest expense consists of interest incurred on the \$175.0 million aggregate principal amount of 6.5% senior notes due July 2, 2029, or the senior notes, that we issued on July 2, 2019. Interest on the senior notes is paid semi-annually in arrears on each January 2 and July 2, which commenced on January 2, 2020.

Reportable segment

We report results under one segment, which we refer to as our “underwriting segment.” Our underwriting segment captures the results of our underwriting lines of business, which are comprised of specialty products on a worldwide basis. We also have a corporate function that includes accelerated expense for the unamortized original issue discount and underwriting fees relating to the partial redemption of our 8½% cumulative redeemable preference shares, or the preference shares, and interest expense on our senior notes as well as certain operating expenses related to corporate activities referred to as certain corporate expenses. Certain corporate expenses are generally comprised of non-recurring costs of the holding company, such as costs associated with the initial setup of subsidiaries, accelerated compensation expense recognition for retirement eligible employees, and costs associated with the ongoing operations of the holding company such as compensation of certain executives (refer to “- Reconciliation of non-U.S. GAAP financial measures” for a discussion about certain corporate expenses).

Recent developments

In December 2019, we entered into an agreement to acquire Axeria IARD, a P&C insurance company based in France. The completion of this acquisition is subject to regulatory approval and other customary closing conditions, and is expected to close in the third quarter of 2020. If this pending acquisition is consummated, consistent with our business model, our strategy will be to work closely with Arch to enable Axeria IARD to grow its existing business in France as well as to develop new insurance opportunities throughout the European Union.

John Rathgeber retired as Chief Executive Officer on March 31, 2020. Mr. Rathgeber remains a member of Watford’s board of directors and serves as a senior advisor to the Company. Jonathan D. Levy succeeded Mr. Rathgeber as our Chief Executive Officer. Mr. Levy’s appointment is subject to Bermuda immigration approval.

Consolidated results - for the three months ended March 31, 2020 and 2019

The following table summarizes our results of operations for the three months ended March 31, 2020 and 2019:

	Three Months Ended March 31,		
	2020	% Change	2019
	(\$ in thousands)		
Gross premiums written	\$ 234,902	25.8 %	\$ 186,689
Gross premiums ceded	(48,202)		(41,302)
Net premiums written	186,700	28.4 %	145,387
Net premiums earned	140,039	(4.1)%	146,094
Loss and loss adjustment expenses	(110,676)		(110,850)
Acquisition expenses	(28,367)		(33,974)
General and administrative expenses (1)	(7,139)		(7,240)
Underwriting income (loss) (2)	(6,143)	2.9 %	(5,970)
Other underwriting income (loss)	133		592
Interest income	37,824		43,141
Investment management fees - related parties	(4,352)		(4,409)
Borrowing and miscellaneous other investment expenses	(5,669)		(8,298)
Net interest income	27,803		30,434
Realized and unrealized gain (loss) on investments	(290,502)		33,720
Investment performance fees - related parties	—		(5,800)
Net investment income (loss)	(262,699)	N.M.	58,354
Interest expense	(2,912)		—
Net foreign exchange gains (losses)	5,013		(437)
Income tax expense	—		—
Net income (loss) before preference dividends	(266,608)		52,539
Preference dividends	(1,171)		(4,907)
Net income (loss) available to common shareholders	\$ (267,779)	N.M.	\$ 47,632

N.M. - Percentage change is not meaningful.

	Three Months Ended March 31,		
	2020	Change	2019
	(\$ in thousands)		
Loss ratio	79.0%	3.1 %	75.9%
Acquisition expense ratio	20.3%	(3.0)%	23.3%
General & administrative expense ratio	5.1%	0.2 %	4.9%
Combined ratio	104.4%	0.3 %	104.1%
Adjusted underwriting income (loss)(2)	\$ (3,014)		\$ (3,415)
Adjusted combined ratio (2)	102.2%	(0.1)%	102.3%
Annualized return on average equity (3)	N.M.		20.8%

N.M. Ratio is not meaningful.

(1) General and administrative expenses include certain corporate expenses. Refer to "Reconciliation of non-U.S. GAAP financial measures-Reconciliation of the adjusted combined ratio," for a discussion of these certain corporate expenses.

(2) Underwriting income (loss), adjusted underwriting income (loss) and the adjusted combined ratio are non-U.S. GAAP financial measures. Refer to "Reconciliation of non-U.S. GAAP financial measures" for a reconciliation of our underwriting income (loss) to net

income (loss) available to common shareholders in accordance with U.S. GAAP, a reconciliation of our adjusted underwriting income (loss) to underwriting income (loss) and a reconciliation of our adjusted combined ratio to our combined ratio.

(3) Annualized return on average equity represents net income (loss) expressed as a percentage of average total shareholders' equity during the period. Annualized return on average equity for the three months ended March 31, 2019 is calculated by extrapolating the quarterly return on average equity over a twelve-month period. For the three-month period, the average total shareholders' equity is calculated as the average of the beginning and ending total shareholders' equity of each quarterly period. Due to the net realized and unrealized losses on investments, the annualized return on average equity calculation is not meaningful for the three months ended March 31, 2020. For the three months ended March 31, 2020 and 2019, the return on average equity was (37.3)% and 5.2%, respectively.

Results for the three months ended March 31, 2020 versus 2019:

The net loss attributable to common shareholders was \$267.8 million in the 2020 first quarter, compared to net income attributable to common shareholders of \$47.6 million in the 2019 first quarter. The 2020 first quarter net loss was driven by a decrease in net investment income due to an increase in realized and unrealized losses on investments. The 2020 first quarter net investment return reflected the impact of the COVID-19 global pandemic and the adverse economic and market conditions that followed.

The net investment loss was \$262.7 million in the 2020 first quarter, compared to a net investment income of \$58.4 million in the 2019 first quarter. The net investment loss was primarily due to realized and unrealized losses of \$290.5 million in the 2020 first quarter, compared to a realized and unrealized gain of \$33.7 million in the 2019 first quarter.

The 2020 first quarter underwriting loss of \$6.1 million was in line with the 2019 first quarter underwriting loss of \$6.0 million. The 2020 first quarter loss ratio was 79.0%, 3.1 points higher than the 2019 first quarter. The 2020 first quarter acquisition expense ratio was 20.3%, 3.0 points lower than the 2019 first quarter. The increase in loss ratio and corresponding decrease in acquisition expense ratio were driven by losses incurred related to the COVID-19 global pandemic, which impacted our mortgage reinsurance business. A portion of this increase in losses was offset by loss sensitive commission decreases, which are reflected as benefits to the acquisition expense ratio. The remaining difference was attributable to changes in the mix of business.

The prior year loss reserve development for both the 2020 and 2019 first quarters was essentially flat.

The 2020 first quarter general and administrative expense ratio was 5.1%, 0.2 points higher than the prior year quarter. The increase this quarter versus the 2019 first quarter reflected ongoing public company corporate expenses.

Premiums

Our underwriting segment captures the results of our underwriting lines of business, which are comprised of specialty products on a worldwide basis. Our four major lines of business are described as follows:

- *Casualty reinsurance*: coverage provided to ceding company clients on third-party liability and workers' compensation exposures, primarily on a treaty basis. Business written includes coverages such as: executive assurance, medical malpractice liability, other professional liability, workers' compensation, excess and umbrella liability and excess auto liability.
- *Other specialty reinsurance*: coverage provided to ceding company clients for personal and commercial auto (other than excess auto liability), mortgage, surety, accident and health, workers' compensation catastrophe, agriculture, marine and aviation.
- *Property catastrophe reinsurance*: protects ceding company clients for most catastrophic losses that are covered in the underlying policies. Perils covered may include hurricane, earthquake, flood, tornado, hail and fire, and coverage for other perils on a case-by-case basis. Property catastrophe reinsurance provides coverage on an excess of loss basis when aggregate losses and

loss adjustment expense from a single occurrence of a covered peril exceed the retention specified in the contract.

- *Insurance programs and coinsurance:* targeting program managers and/or coinsurers with unique expertise and niche products offering primary and excess general liability, umbrella liability, professional liability, workers' compensation, personal and commercial automobile, inland marine and property business with minimal catastrophe exposure.

Gross premiums written

Gross premiums written for the three months ended March 31, 2020 and 2019 were as follows:

	Three Months Ended March 31,			
	2020		2019	
	Amount	%	Amount	%
	(\$ in thousands)			
Casualty reinsurance	\$ 83,818	35.7%	\$ 75,601	40.5%
Other specialty reinsurance	36,880	15.7%	24,298	13.0%
Property catastrophe reinsurance	9,832	4.2%	5,992	3.2%
Insurance programs and coinsurance	104,372	44.4%	80,798	43.3%
Total	\$ 234,902	100.0%	\$ 186,689	100.0%

Results for the three months ended March 31, 2020 versus 2019:

Gross premiums written were \$234.9 million for the three months ended March 31, 2020, compared to \$186.7 million for the three months ended March 31, 2019, an increase of \$48.2 million, or 25.8%. Premium growth was achieved across all lines of business.

Casualty reinsurance and other specialty reinsurance gross premiums increased 10.9% and 51.8%, respectively, over the prior year quarter, primarily due to increased personal and commercial auto writings. The casualty reinsurance increase was primarily due to increased U.K. motor excess of loss writings, while the other specialty reinsurance premium increase was primarily attributable to U.K. and Irish motor proportional business writings.

Our property catastrophe reinsurance gross premiums written increased 64.1% over the prior year quarter. Our primary involvement in this line of business is a 7.5% quota share participation of ARL's world-wide property catastrophe excess of loss portfolio. Recently, Arch has been increasing its writings in this line in response to an improving rate environment and, as a result, our premiums have grown in proportion.

The growth in our insurance programs and coinsurance line of business was driven by the continued expansion of our U.S. insurance business. During the 2020 first quarter, WSIC and WIC collectively grew their insurance programs and coinsurance gross premiums written by \$26.7 million, or 102.6%, to \$52.6 million. WICE insurance gross premiums written decreased slightly, by \$3.1 million or 5.6%, to \$51.7 million during the 2020 first quarter.

Premiums ceded

Premiums ceded were \$48.2 million for the three months ended March 31, 2020, compared to \$41.3 million for the three months ended March 31, 2019, an increase of \$6.9 million. Premiums ceded increased during the period, as our insurance gross premiums written have grown in our WSIC and WIC companies and outward ceded premiums to Arch have grown in proportion.

Net premiums written

Net premiums written for the three months ended March 31, 2020 and 2019 were as follows:

	Three Months Ended March 31,			
	2020		2019	
	Amount	%	Amount	%
	(\$ in thousands)			
Casualty reinsurance	\$ 83,667	44.8%	\$ 75,065	51.6%
Other specialty reinsurance	35,484	19.0%	23,182	15.9%
Property catastrophe reinsurance	9,832	5.3%	5,982	4.1%
Insurance programs and coinsurance	57,717	30.9%	41,158	28.3%
Total	\$ 186,700	100.0%	\$ 145,387	100.0%

Results for the three months ended March 31, 2020 versus 2019:

Net premiums written were \$186.7 million for the three months ended March 31, 2020, compared to \$145.4 million for the three months ended March 31, 2019, an increase of \$41.3 million or 28.4%. The 2020 first quarter increase in net reinsurance premiums written was consistent with the increase in gross reinsurance premiums written. The 2020 first quarter insurance programs and coinsurance growth was slightly higher than growth in gross premiums written versus the prior year quarter, as the new business written in the United States has a higher retained percentage than the existing business.

Net premiums earned

Net premiums earned for the three months ended March 31, 2020 and 2019 were as follows:

	Three Months Ended March 31,			
	2020		2019	
	Amount	%	Amount	%
	(\$ in thousands)			
Casualty reinsurance	\$ 52,765	37.7%	\$ 63,313	43.3%
Other specialty reinsurance	35,364	25.3%	44,561	30.5%
Property catastrophe reinsurance	4,884	3.5%	2,971	2.0%
Insurance programs and coinsurance	47,026	33.5%	35,249	24.1%
Total	\$ 140,039	100.0%	\$ 146,094	100.0%

Results for the three months ended March 31, 2020 versus 2019:

Net premiums earned were \$140.0 million for the three months ended March 31, 2020 compared to \$146.1 million for the three months ended March 31, 2019, a decrease of \$6.1 million or 4.1%. The decrease in net premiums earned reflected a non-renewal of one multi-line quota share contract within casualty reinsurance and a non-recurring exposure within other specialty reinsurance earned in the 2019 first quarter. This was partially offset by increased writings in insurance programs and coinsurance, and, to a lesser extent, property catastrophe reinsurance during the 2020 first quarter.

Loss ratio

The following table shows the components of our loss and loss adjustment expenses for the three months ended March 31, 2020 and 2019:

	Three Months Ended March 31,			
	2020		2019	
	Loss and Loss Adjustment Expenses	% of Earned Premiums	Loss and Loss Adjustment Expenses	% of Earned Premiums
	(\$ in thousands)			
Current year	\$ 110,856	79.1 %	\$ 110,901	75.9%
Prior year development (favorable)/adverse	(180)	(0.1)%	(51)	—%
Loss and loss adjustment expenses	\$ 110,676	79.0 %	\$ 110,850	75.9%

Results for the three months ended March 31, 2020 versus 2019:

Our loss ratio was 79.0% for the three months ended March 31, 2020, compared to 75.9% for the three months ended March 31, 2019, an increase of 3.1 points. The increase in loss ratio and corresponding decrease in acquisition expense ratio were driven by losses incurred related to the COVID-19 global pandemic, which impacted our mortgage reinsurance business. A portion of this increase in losses was offset by loss sensitive commission decreases, which are reflected as benefits to the acquisition expense ratio. Other movements in the loss ratio reflected changes in mix and the type of business. The prior year loss reserve development for both the 2020 and 2019 first quarters was essentially flat.

Refer to [Note 5, "Reserve for losses and loss adjustment expenses"](#) to our consolidated financial statements for more information about our prior year reserve development.

Acquisition expense ratio

Results for the three months ended March 31, 2020 versus 2019:

Our acquisition expense ratio was 20.3% for the three months ended March 31, 2020, a reduction of 3.0 points from the three months ended March 31, 2019. The decrease in acquisition expense ratio and corresponding increase in loss ratio were driven by losses incurred related to the COVID-19 global pandemic, which impacted our other specialty reinsurance business, as discussed above.

General and administrative expense ratio

Results for the three months ended March 31, 2020 versus 2019:

Our general and administrative expense ratio was 5.1% for the three months ended March 31, 2020, compared to 4.9% for the three months ended March 31, 2019. The 0.2 point increase this quarter reflected ongoing public company corporate expenses.

Combined ratio

Results for the three months ended March 31, 2020 versus 2019:

Our combined ratio was 104.4% for the three months ended March 31, 2020, compared to 104.1% for the three months ended March 31, 2019, an increase of 0.3%. In the 2020 first quarter, there was a 3.1 point increase in the loss expense ratio and a 0.2 point increase in the general and administrative expense ratio, offset in part by a 3.0 point decrease in the acquisition expense ratio, versus the prior period, as described above.

Investing results

The following table summarizes the components of total investment income:

	Three Months Ended March 31,	
	2020	2019
	(\$ in thousands)	
Interest income	\$ 37,824	\$ 43,141
Investment management fees - related parties	(4,352)	(4,409)
Borrowing and miscellaneous other investment expenses	(5,669)	(8,298)
Net interest income	27,803	30,434
Net realized gains (losses) on investments	(5,046)	1,282
Net unrealized gains (losses) on investments	(285,456)	32,438
Investment performance fees - related parties	—	(5,800)
Net investment income (loss)	\$ (262,699)	\$ 58,354
Net interest income yield on average net assets (1)	1.4 %	1.5%
Non-investment grade portfolio (1)	1.7 %	1.9%
Investment grade portfolio (1)	0.5 %	0.6%
Net investment income return on average net assets (1)	(13.0)%	2.8%
Non-investment grade portfolio (1)	(17.4)%	3.4%
Investment grade portfolio (1)	0.8 %	1.1%
Net investment income return on average total investments (excluding accrued investment income) (2)	(10.1)%	2.1%
Non-investment grade portfolio (2)	(14.9)%	2.7%
Investment grade portfolio (2)	0.8 %	1.1%

(1) Net interest income yield on average net assets and net investment income return on average net assets are calculated by dividing net interest income, and net investment income (loss), respectively, by average net assets. Net assets is calculated as the sum of total investments, accrued investment income and receivables for securities sold, less revolving credit agreement borrowings, payable for securities purchased and payable for securities sold short. For the three-month period, average net assets is calculated using the averages of each quarterly period. However, for the investment grade portfolio component of these returns, the impact of the revolving credit agreement borrowings is not subtracted from net interest income, net investment income (loss), or the net assets calculation. The separate components of these returns (non-investment grade portfolio and investment grade portfolio) are non-U.S. GAAP financial measures. Refer to “-Reconciliation of non-U.S. GAAP financial measures” for a reconciliation of these components of our net interest income yield on average net assets and net investment income return on average net assets.

(2) Net investment income return on average total investments (excluding accrued investment income) is calculated by dividing net investment income by average total investments. For the three-month period, average total investments is calculated using the averages of each quarterly period. However, for the investment grade portfolio component of these returns, the impact of revolving credit agreement borrowings is not subtracted from net investment income. The separate components of these returns (non-investment grade portfolio and investment grade portfolio) are non-U.S. GAAP financial measures. Refer to “-Reconciliation of non-U.S. GAAP financial measures” for a reconciliation of these components of our net investment income return on average total investments (excluding accrued investment income).

Results for the three months ended March 31, 2020 versus 2019:

Net investment loss was \$262.7 million for the three months ended March 31, 2020 compared to net investment income of \$58.4 million for the three months ended March 31, 2019, a decrease of \$321.1 million. The 2020 first quarter net investment income return on average net assets was (13.0)% as compared to 2.8% for the 2019 first quarter.

The 2020 first quarter net investment return was driven by net realized and unrealized losses of \$290.5 million due to investment market volatility caused by the economic shutdown mandated by governments around the world related to the COVID-19 global pandemic. The net realized and

unrealized losses on investments was partially offset by net interest income of \$27.8 million in the 2020 first quarter.

The 2020 first quarter non-investment grade portfolio net interest income yield was 1.7%, compared to 1.9% in the 2019 first quarter. The decrease in yield was driven by a decrease in LIBOR rates and its impact on our floating rate assets, as well as the deliberate use of less investment leverage, and therefore a lower net asset base, in the first quarter of 2020 versus the prior year quarter.

The non-investment grade portfolio net unrealized losses reported in the 2020 first quarter were \$285.5 million, compared to a net unrealized gain of \$27.6 million in the 2019 first quarter. The net unrealized losses reflected investment market volatility caused by the economic dislocation resulting from the COVID-19 global pandemic.

The 2020 first quarter investment grade portfolio net interest income yield was 0.5%, consistent with 0.6% in the prior period.

In addition, during the first quarter of 2020, the investment grade available for sale portfolio experienced \$38.0 million of unrealized holding losses, as disclosed within the statement of other comprehensive income (loss). The unrealized holding losses reflected investment market volatility caused by the economic dislocation resulting from the COVID-19 global pandemic.

Growth in book value per diluted common share

Results for the three months ended March 31, 2020 versus 2019:

Book value per diluted common share was \$28.21 as of March 31, 2020, compared to \$43.49 per share as of December 31, 2019. The decrease was driven by a net loss of \$267.8 million and a net other comprehensive loss of \$37.8 million.

Reconciliation of non-U.S. GAAP financial measures

Underwriting income (loss), adjusted underwriting income (loss), adjusted combined ratio and the non-investment grade portfolio and investment grade portfolio components of our investment returns (net interest income yield on average net assets, and net investment income return on average net assets and on average total investments (excluding accrued investment income), respectively) are non-U.S. GAAP financial measures. We use these measures, together with the GAAP financial statements, to provide information that assists with analyzing our performance. As a result, certain income and expense items are excluded from these measures in an effort to allow an effective analysis. With respect to expenses, we do not view certain operating expenses related to corporate activities, referred to as certain corporate expenses, as part of our underwriting activities. These expenses are generally comprised of non-recurring costs of the holding company, such as costs associated with the initial setup of subsidiaries, as well as costs associated with the ongoing operations of the holding company such as compensation of certain executives. The following are descriptions of each of the non-U.S. GAAP financial measures used by us.

Underwriting income (loss) is useful in evaluating our underwriting performance, without regard to other underwriting income (losses), net investment income (losses), interest expense, net foreign exchange gains (losses), income tax expenses and preference dividends.

Adjusted underwriting income (loss) is useful in evaluating our underwriting performance, without regard to net investment income (losses), interest expense, net foreign exchange gains (losses), income tax expenses, preference dividends and certain corporate expenses (which are described in more detail above). We define underwriting income (loss) as net premiums earned, less loss and loss adjustment expenses, acquisition expenses and general and administrative expenses, and we define adjusted underwriting income (loss) as underwriting income (loss) plus other underwriting income (loss) less certain corporate expenses. Our adjusted combined ratio is a key indicator of our profitability, without regard to certain corporate expenses. We calculate the adjusted combined ratio by dividing the sum of loss and loss adjustment expenses, acquisition expenses and general and administrative expenses less certain corporate expenses by the sum of net premiums earned and other underwriting income (loss).

The non-investment grade portfolio and investment grade portfolio components of our investment returns (net interest income yield on average net assets, and net investment income return on average net assets and on average total investments (excluding accrued investment income), respectively) are useful in evaluating our investment performance. The non-investment grade portfolio component of these investment returns reflect the performance of our investment strategy under HPS, which includes the use of leverage. The investment grade portfolio component of these investment returns reflect the performance of the investment portfolios that predominantly support our underwriting collateral.

We use underwriting income (loss), adjusted underwriting income (loss) and the adjusted combined ratio and the separate components of our returns (non-investment grade portfolio and investment grade portfolio) as internal performance measures in the management of our operations because we believe they give us and users of our financial information useful insight into our results of operations and our underlying business performance. Underwriting income (loss) and adjusted underwriting (income) loss should not be viewed as a substitute for net income (loss) calculated in accordance with U.S. GAAP, and our adjusted combined ratio should not be viewed as a substitute for our combined ratio. Furthermore, other companies may define these measures differently.

Reconciliation of underwriting income (loss) and adjusted underwriting income (loss)

Underwriting income (loss) reconciles to net income (loss) available to common shareholders, and adjusted underwriting income (loss) reconciles to underwriting income (loss) for the three months ended March 31, 2020 and 2019 as follows:

	Three Months Ended March 31,	
	2020	2019
	(\$ in thousands)	
Net income (loss) available to common shareholders	\$ (267,779)	\$ 47,632
Preference dividends	1,171	4,907
Net income (loss) before dividends	(266,608)	52,539
Income tax expense	—	—
Interest expense	2,912	—
Net foreign exchange (gains) losses	(5,013)	437
Net investment (income) loss	262,699	(58,354)
Other underwriting (income) loss	(133)	(592)
Underwriting income (loss)	(6,143)	(5,970)
Certain corporate expenses	2,996	1,963
Other underwriting income (loss)	133	592
Adjusted underwriting income (loss)	\$ (3,014)	\$ (3,415)

Reconciliation of the adjusted combined ratio

The adjusted combined ratio reconciles to the combined ratio for the three months ended March 31, 2020 and 2019 as follows:

	Three Months Ended March 31,					
	2020			2019		
	Amount	Adjustment	As Adjusted	Amount	Adjustment	As Adjusted
	(\$ in thousands)					
Losses and loss adjustment expenses	\$ 110,676	\$ —	\$ 110,676	\$ 110,850	\$ —	\$ 110,850
Acquisition expenses	28,367	—	28,367	33,974	—	33,974
General & administrative expenses (1)	7,139	(2,996)	4,143	7,240	(1,963)	5,277
Net premiums earned (1)(2)	140,039	133	140,172	146,094	592	146,686
Loss ratio	79.0%			75.9%		
Acquisition expense ratio	20.3%			23.3%		
General & administrative expense ratio (1)	5.1%			4.9%		
Combined ratio	104.4%			104.1%		
Adjusted loss ratio			79.0%			75.6%
Adjusted acquisition expense ratio			20.2%			23.2%
Adjusted general & administrative expense ratio			3.0%			3.5%
Adjusted combined ratio			102.2%			102.3%

(1) Adjustments include certain corporate expenses, which are deducted from general and administrative expenses, and other underwriting income (loss), which is added to net premiums earned.

(2) The adjustment to net premiums earned relates to "other underwriting income" from underwriting contracts accounted for as derivatives.

Reconciliation of the non-investment grade portfolio and investment grade portfolio components of our investment returns

The non-investment grade portfolio and the investment grade portfolio components of our investment returns for the three months ended March 31, 2020 and 2019 are as follows:

	Three Months Ended March 31, 2020				Three Months Ended March 31, 2019			
	Non-Investment Grade	Investment Grade	Cost of U/W Collateral (4)	Total	Non-Investment Grade	Investment Grade	Cost of U/W Collateral (4)	Total
	(\$ in thousands)							
Interest income	\$ 32,764	\$ 5,060	\$ —	\$ 37,824	\$ 37,339	\$ 5,802	\$ —	\$ 43,141
Investment management fees - related parties	(3,973)	(379)	—	(4,352)	(4,071)	(338)	—	(4,409)
Borrowing and miscellaneous other investment expenses	(2,591)	(225)	(2,853)	(5,669)	(4,858)	(204)	(3,236)	(8,298)
Net interest income	26,200	4,456	(2,853)	27,803	28,410	5,260	(3,236)	30,434
Net realized gains (losses) on investments	(7,225)	2,179	—	(5,046)	1,319	(37)	—	1,282
Net unrealized gains (losses) on investments (1)	(285,493)	37	—	(285,456)	27,625	4,813	—	32,438
Investment performance fees - related parties	—	—	—	—	(5,800)	—	—	(5,800)
Net investment income (loss)	\$ (266,518)	\$ 6,672	\$ (2,853)	\$ (262,699)	\$ 51,554	\$ 10,036	\$ (3,236)	\$ 58,354
Average total investments (excluding accrued investment income) (2)	\$1,790,337	\$820,635	\$ —	\$2,610,972	\$1,895,843	\$888,424	\$ —	\$2,784,267
Average net assets (3)	\$1,530,825	\$826,062	\$(328,750)	\$2,028,137	\$1,506,245	\$886,927	\$(316,987)	\$2,076,185
Net interest income yield on average net assets (3)	1.7 %	0.5%		1.4 %	1.9%	0.6%		1.5%
Net investment income return on average total investments (excluding accrued investment income) (2)	(14.9)%	0.8%		(10.1)%	2.7%	1.1%		2.1%
Net investment income return on average net assets (3)	(17.4)%	0.8%	(0.9)%	(13.0)%	3.4%	1.1%	(1.0)%	2.8%

(1) Net unrealized gains (losses) on investments excludes unrealized gains and losses from the available for sale portfolios, which are recorded in other comprehensive income.

(2) Net investment income return on average total investments (excluding accrued investment income) is calculated by dividing net investment income by average total investments. For the three-month period, average total investments is calculated using the average of the beginning and ending balance of each quarterly period. However, for the investment grade portfolio component of these returns, the impact of revolving credit agreement borrowings is not subtracted from net investment income.

(3) Net interest income yield on average net assets and net investment income return on average net assets are calculated by dividing net interest income, and net investment income (loss), respectively, by average net assets. For the non-investment grade component of investment returns and total investment returns, net assets is calculated as the sum of total investments, accrued investment income and receivables for securities sold, less total revolving credit agreement borrowings, payable for securities purchased and payable for securities sold short. However, for the investment grade portfolio component of these returns, the impact of the revolving credit agreement borrowings is not subtracted from net interest income, net investment income (loss), or the net assets calculation.

(4) The cost of underwriting collateral is calculated as the revolving credit agreement expenses for the investment grade portfolios divided by the average total revolving credit agreement borrowings for the investment grade portfolios during the period.

	As of March 31, 2020				As of March 31, 2019			
	Non-Investment Grade	Investment Grade	Borrowings for U/W Collateral	Total	Non-Investment Grade	Investment Grade	Borrowings for U/W Collateral	Total
	(\$ in thousands)							
Average total investments (excluding accrued investment income) - QTD	\$ 1,790,337	\$ 820,635	\$ —	\$ 2,610,972	\$ 1,895,843	\$ 888,424	\$ —	\$ 2,784,267
Average net assets - QTD	1,530,825	826,062	(328,750)	2,028,137	1,506,245	886,927	(316,987)	2,076,185
Total investments	\$ 1,718,421	\$ 794,385	\$ —	\$ 2,512,806	\$ 1,909,095	\$ 921,071	\$ —	\$ 2,830,166
Accrued Investment Income	12,312	4,032	—	16,344	13,300	4,046	—	17,346
Receivable for Securities Sold	22,329	4,460	—	26,789	62,365	201	—	62,566
Less: Payable for Securities Purchased	61,834	1,995	—	63,829	83,189	12,388	—	95,577
Less: Payable for Securities Sold Short	30,076	—	—	30,076	28,737	—	—	28,737
Less: Revolving credit agreement borrowings	247,736	—	328,750	576,486	326,256	—	326,487	652,743
Net assets	\$ 1,413,416	\$ 800,882	\$ (328,750)	\$ 1,885,548	\$ 1,546,578	\$ 912,930	\$ (326,487)	\$ 2,133,021
Non-investment grade borrowing ratio (1)	17.5%				21.1%			
Unrealized gains on investments	\$ 25,439	\$ 15,086	\$ —	\$ 40,525	\$ 28,066	\$ 4,040	\$ —	\$ 32,106
Unrealized losses on investments	(366,188)	(47,603)	—	(413,791)	(104,700)	(6,835)	—	(111,535)
Net unrealized gains (losses) on investments	\$ (340,749)	\$ (32,517)	\$ —	\$ (373,266)	\$ (76,634)	\$ (2,795)	\$ —	\$ (79,429)

(1) The non-investment grade borrowing ratio is calculated as revolving credit agreement borrowings divided by net assets.

Critical accounting policies, estimates and recent accounting pronouncements

The preparation of consolidated financial statements in accordance with GAAP requires us to make many estimates and judgments that affect the reported amounts of assets, liabilities (including reserves), revenues and expenses, and related disclosures of contingent liabilities. On an ongoing basis, we evaluate our estimates, including those related to revenue recognition, insurance and other reserves, reinsurance recoverables and fair value measurements. We base our estimates on historical experience, where possible, and on various other assumptions that we believe to be reasonable under the circumstances, which form the basis for our judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Estimates and judgments for a relatively new company, like our company, are even more difficult to make than those made in a mature company since we have compiled relatively limited historical information through March 31, 2020. Actual results will differ from these estimates and such differences may be material.

The critical accounting policies that we believe affect significant estimates used in the preparation of our consolidated financial statements, as well as certain recent accounting pronouncements, are discussed under the heading “Management’s discussion and analysis of financial condition and results of operations-Critical accounting policies, estimates and recent accounting pronouncements” contained in our Annual Report on Form 10-K for the year ending December 31, 2019, updated, where applicable, in the notes accompanying our consolidated financial statements included in this report, including Note 2, “Basis of presentation and significant accounting policies”.

Financial condition, liquidity and capital resources

General

We are a holding company whose assets primarily consist of the shares in our subsidiaries. Generally, we depend on our available cash resources, dividends or other distributions from subsidiaries to make payments, including the payment of interest on our senior notes, dividends on our preference shares and operating expenses we may incur. During the three months ended March 31, 2020 and the year ended December 31, 2019, we received dividends of \$1.1 million and \$13.4 million, respectively, from Watford Re, our Bermuda operating subsidiary.

The ability of our regulated operating subsidiaries to pay dividends or make distributions is dependent on their ability to meet applicable regulatory standards. Under Bermuda law, Watford Re is required to maintain an enhanced capital requirement, or ECR, which must equal or exceed its minimum solvency margin (in other words, the amount by which the value of its general business assets must exceed its general business liabilities). Watford Re is also required to maintain a minimum liquidity ratio whereby the value of its relevant assets is not less than 75% of the amount of its relevant liabilities for general business. Watford Re is prohibited from declaring or paying any dividends during any financial year if it is not in compliance with each of its ECR, minimum solvency margin and minimum liquidity ratio. In any financial year, Watford Re is prohibited from declaring or paying dividends of more than 25% of its total statutory capital and surplus (as shown on its previous financial year’s statutory balance sheet) unless it files, at least seven days before payment of such dividends, with the Bermuda Monetary Authority, or the BMA, an affidavit attesting that a dividend would not cause Watford Re to fail to meet its relevant margins. As of December 31, 2019, as determined under Bermuda law, Watford Re had a statutory capital and surplus of \$1.1 billion and was in compliance with its ECR, minimum solvency margin and minimum liquidity ratio. Accordingly, as of December 31, 2019, Watford Re was able to pay dividends of up to \$276.6 million to us during 2020 without the requirement of filing such an affidavit with the BMA. This is subject to ongoing monitoring of capital throughout 2020. In addition, Watford Re is prohibited, without prior approval of the BMA, from reducing by 15% or more its total statutory capital, as set out in its previous year’s statutory financial statements.

Our U.S. and Gibraltar insurance subsidiaries are subject to similar insurance laws and regulations in the jurisdictions in which they operate. The ability of these insurance subsidiaries to pay dividends or make distributions is also dependent on their ability to meet applicable regulatory standards.

Furthermore, the ability of our operating subsidiaries to pay dividends to us and to intermediate subsidiaries owned by us could be constrained by our dependence on financial strength ratings from independent rating agencies. Our ratings from these agencies depend to a large extent on the capitalization levels of our operating subsidiaries. We believe that we have sufficient cash resources and available dividend capacity to service our indebtedness, pay required dividends on our preference shares and satisfy other current outstanding obligations.

Financial condition

Shareholders' equity

2020 versus 2019: Total shareholders' equity was \$564.1 million as of March 31, 2020, compared to \$872.4 million as of December 31, 2019, a decrease of \$308.3 million or 35.3%. The decrease in shareholders' equity was primarily driven by net investment loss of \$262.7 million, an other comprehensive loss of \$37.8 million, an underwriting loss of \$6.1 million, an interest expense of \$2.9 million, and preference dividends of \$1.2 million. In addition, the repurchase of 127,744 common shares during the 2020 first quarter under our \$50 million share repurchase program reduced shareholders' equity by \$2.9 million.

Investment portfolios

The table below summarizes the credit quality of our non-investment grade and investment grade portfolios as of March 31, 2020 and December 31, 2019, as rated by Standard & Poor's Financial Services, LLC, or Standard & Poor's, Moody's Investors Service, or Moody's, Fitch Ratings Inc., or Fitch, or Kroll Bond Rating Agency, or KBRA, DBRS Morningstar, or DBRS, as applicable:

March 31, 2020	Credit Rating (1)											
	Fair Value	AAA	AA	A	BBB	BB	B	CCC	CC	C	D	Not Rated
(\$ in thousands)												
Non-Investment Grade Portfolio:												
Term loan investments	\$ 906,999	\$ —	\$ —	\$ —	\$ —	\$ 10,277	\$ 650,028	\$ 161,307	\$ 2,823	\$ 1,314	\$ 1,590	\$ 79,660
Corporate bonds	240,570	—	—	—	5,933	14,447	84,955	118,847	1,872	—	3,699	10,817
Asset-backed securities	140,613	—	—	3,339	85,572	19,727	7,395	1,418	—	—	—	23,162
Mortgage-backed securities	8,529	—	—	—	—	1,190	—	—	—	—	2,552	4,787
Short-term investments	269,768	26,024	133,548	402	62,091	—	40,000	—	—	—	—	7,703
Total fixed income instruments and short-term investments	1,566,479	26,024	133,548	3,741	153,596	45,641	782,378	281,572	4,695	1,314	7,841	126,129
Other Investments	30,682											
Equities	121,260											
Total Non-Investment Grade Portfolio	\$ 1,718,421	\$ 26,024	\$ 133,548	\$ 3,741	\$ 153,596	\$ 45,641	\$ 782,378	\$ 281,572	\$ 4,695	\$ 1,314	\$ 7,841	\$ 126,129
Investment Grade Portfolio:												
Corporate bonds	\$ 167,570	\$ —	\$ 34,647	\$ 76,063	\$ 52,085	\$ 4,775	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
U.S. government and government agency bonds	265,423	—	265,423	—	—	—	—	—	—	—	—	—
Asset-backed securities	113,583	1,628	—	15,980	95,975	—	—	—	—	—	—	—
Mortgage-backed securities	21,785	—	—	4,600	17,185	—	—	—	—	—	—	—
Non-U.S. government and government agency bonds	149,858	—	149,858	—	—	—	—	—	—	—	—	—
Municipal government and government agency bonds	2,073	1,023	570	480	—	—	—	—	—	—	—	—
Short-term investments	74,093	4,150	21,239	—	48,704	—	—	—	—	—	—	—
Total Investment Grade Portfolio	\$ 794,385	\$ 6,801	\$ 471,737	\$ 97,123	\$ 213,949	\$ 4,775	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Total	\$ 2,512,806	\$ 32,825	\$ 605,285	\$ 100,864	\$ 367,545	\$ 50,416	\$ 782,378	\$ 281,572	\$ 4,695	\$ 1,314	\$ 7,841	\$ 126,129

(1) For individual fixed maturity investments, Standard & Poor's ratings are used. In the absence of a Standard & Poor's rating, ratings from Moody's are used, followed by ratings from Fitch, followed by ratings from KBRA, followed by ratings from DBRS.

December 31, 2019	Credit Rating (1)											Not Rated
	Fair Value	AAA	AA	A	BBB	BB	B	CCC	CC	C	D	
(\$ in thousands)												
Non-Investment Grade Portfolio												
Term loan investments	\$ 1,061,934	\$ —	\$ —	\$ —	\$ —	\$ 9,617	\$761,168	\$215,909	\$6,823	\$2,119	\$ —	\$ 66,298
Corporate bonds	213,841	—	—	—	—	9,003	58,345	135,613	—	—	—	10,880
Asset-backed securities	190,738	—	—	4,002	105,706	29,695	18,381	—	—	—	—	32,954
Mortgage-backed securities	7,706	—	—	—	—	976	—	—	—	—	2,497	4,233
Short-term investments	232,436	—	116,805	34,903	64,108	—	—	8,359	—	—	—	8,261
Total fixed income instruments and short-term investments	1,706,655	—	116,805	38,905	169,814	49,291	837,894	359,881	6,823	2,119	2,497	122,626
Other Investments	30,461	—	—	—	—	—	—	—	—	—	—	—
Equities	125,137	—	—	—	—	—	—	—	—	—	—	—
Total Non-Investment Grade Portfolio	\$ 1,862,253	\$ —	\$ 116,805	\$ 38,905	\$ 169,814	\$ 49,291	\$837,894	\$359,881	\$6,823	\$2,119	\$2,497	\$122,626
Investment Grade Portfolio												
Corporate bonds	\$ 158,632	\$ —	\$ 36,128	\$ 81,401	\$ 41,103	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
U.S. government and government agency bonds	285,609	—	285,609	—	—	—	—	—	—	—	—	—
Asset-backed securities	145,433	2,006	—	25,177	118,250	—	—	—	—	—	—	—
Mortgage-backed securities	24,750	—	—	1,100	23,650	—	—	—	—	—	—	—
Non-U.S. government and government agency bonds	133,409	—	132,460	—	949	—	—	—	—	—	—	—
Municipal government and government agency bonds	2,184	1,135	573	476	—	—	—	—	—	—	—	—
Short-term investments	96,867	25,783	20,037	—	51,047	—	—	—	—	—	—	—
Total Investment Grade Portfolio	\$ 846,884	\$ 28,924	\$474,807	\$108,154	\$234,999	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Total	\$ 2,709,137	\$ 28,924	\$591,612	\$147,059	\$404,813	\$ 49,291	\$837,894	\$359,881	\$6,823	\$2,119	\$2,497	\$122,626

(1) For individual fixed maturity investments, Standard & Poor's ratings are used. In the absence of a Standard & Poor's rating, ratings from Moody's are used, followed by ratings from Fitch, followed by ratings from KBRA, followed by ratings from DBRS.

The following tables summarize the composition of the Company's non-investment grade and investment grade portfolios by sector as of March 31, 2020 and December 31, 2019:

	March 31, 2020								
	Total	Financials	Health Care	Technology	Consumer Services	Industrials	Consumer Goods	Oil & Gas	All Other (1)
	(\$ in thousands)								
Non-Investment Grade Portfolio:									
Term loan investments	\$ 906,999	\$ 190,535	\$ 195,084	\$ 199,837	\$ 98,518	\$ 89,778	\$ 40,415	\$ 32,049	\$ 60,783
Corporate bonds	240,570	24,927	43,028	15,702	49,761	27,585	19,947	18,522	41,098
Equities - sector specific	95,112	59,714	27,174	5,868	—	1,026	—	242	1,088
Short-term investments - sector specific	47,703	7,703	—	—	—	—	—	40,000	—
Subtotal	1,290,384	282,879	265,286	221,407	148,279	118,389	60,362	90,813	102,969
Equities - non-sector specific	26,148								
Short-term investments - non-sector specific	222,065								
Asset-backed securities	140,613								
Other investments	30,682								
Mortgage-backed securities	8,529								
Total Non-Investment Grade Portfolio	\$ 1,718,421	\$ 282,879	\$ 265,286	\$ 221,407	\$ 148,279	\$ 118,389	\$ 60,362	\$ 90,813	\$ 102,969
Investment Grade Portfolio:									
Corporate bonds	\$ 167,570	\$ 62,046	\$ 13,752	\$ 12,135	\$ 15,481	\$ 14,133	\$ 34,718	\$ 7,346	\$ 7,959
Short-term investments	74,093								
U.S. government and government agency bonds	265,423								
Non-U.S. government and government agency bonds	149,858								
Asset-backed securities	113,583								
Mortgage-backed securities	21,785								
Municipal government and government agency bonds	2,073								
Total Investment Grade Portfolio	\$ 794,385	\$ 62,046	\$ 13,752	\$ 12,135	\$ 15,481	\$ 14,133	\$ 34,718	\$ 7,346	\$ 7,959
Total Investments	\$ 2,512,806	\$ 344,925	\$ 279,038	\$ 233,542	\$ 163,760	\$ 132,522	\$ 95,080	\$ 98,159	\$ 110,928

(1) Includes telecommunications, utilities and basic materials.

	December 31, 2019								
	Total	Financials	Health Care	Technology	Consumer Services	Industrials	Consumer Goods	Oil & Gas	All Other (1)
	(\$ in thousands)								
Non-Investment Grade Portfolio:									
Term loan investments	\$ 1,061,934	\$ 212,800	\$ 221,982	\$ 232,659	\$ 121,434	\$ 111,912	\$ 46,827	\$ 52,200	\$ 62,120
Corporate bonds	213,841	17,547	19,160	10,972	28,144	13,822	23,491	27,632	73,073
Equities - sector specific	101,551	55,946	30,640	11,263	—	1,283	—	1,040	1,379
Short-term investments - sector specific	16,620	8,261	—	3,030	—	5,329	—	—	—
Subtotal	1,393,946	294,554	271,782	257,924	149,578	132,346	70,318	80,872	136,572
Equities - non-sector specific	23,586								
Short-term investments - non-sector specific	215,816								
Asset-backed securities	190,738								
Other investments	30,461								
Mortgage-backed securities	7,706								
Total Non-Investment Grade Portfolio	\$ 1,862,253	\$ 294,554	\$ 271,782	\$ 257,924	\$ 149,578	\$ 132,346	\$ 70,318	\$ 80,872	\$ 136,572
Investment Grade Portfolio:									
Corporate bonds	\$ 158,632	\$ 72,707	\$ 12,087	\$ 8,035	\$ 11,752	\$ 10,548	\$ 32,046	\$ 5,734	\$ 5,723
Short-term investments	96,867								
U.S. government and government agency bonds	285,609								
Non-U.S. government and government agency bonds	133,409								
Asset-backed securities	145,433								
Mortgage-backed securities	24,750								
Municipal government and government agency bonds	2,184								
Total Investment Grade Portfolio	\$ 846,884	\$ 72,707	\$ 12,087	\$ 8,035	\$ 11,752	\$ 10,548	\$ 32,046	\$ 5,734	\$ 5,723
Total Investments	\$ 2,709,137	\$ 367,261	\$ 283,869	\$ 265,959	\$ 161,330	\$ 142,894	\$ 102,364	\$ 86,606	\$ 142,295

(1) Includes telecommunications, utilities and basic materials.

The fair value of our term loans, fixed maturities and short-term investments in our non-investment grade and investment grade portfolios, summarized by contractual maturity as of March 31, 2020 and December 31, 2019 were as follows:

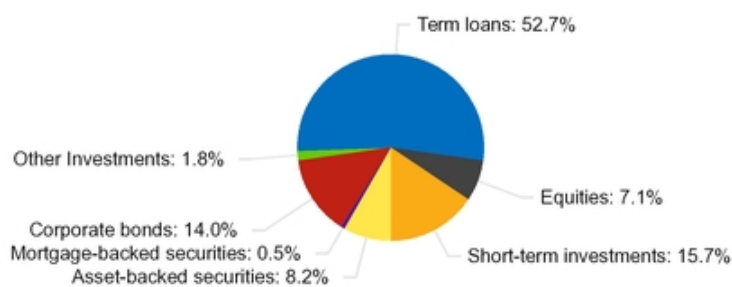
March 31, 2020	Contractual Maturity					
	Fair Value	Due in One Year or Less	Due After One Through Two Years	Due After Three Through Five Years	Due After Five Through Ten Years	Due After Ten Years
(\$ in thousands)						
Non-Investment Grade Portfolio:						
Term loan investments	\$ 906,999	\$ 16,371	\$ 298,644	\$ 219,701	\$ 372,283	\$ —
Corporate bonds	240,570	29	31,289	109,198	100,054	—
Short-term investments	269,768	269,768	—	—	—	—
Subtotal	1,417,337	286,168	329,933	328,899	472,337	—
Asset-backed securities	140,613					
Mortgage-backed securities	8,529					
Other Investments	30,682					
Equities	121,260					
Total Non-Investment Grade Portfolio	\$ 1,718,421	\$ 286,168	\$ 329,933	\$ 328,899	\$ 472,337	\$ —
Investment Grade Portfolio:						
Corporate bonds	\$ 167,570	\$ 8,439	\$ 49,634	\$ 46,347	\$ 51,743	\$ 11,407
U.S. government and government agency bonds	265,423	329	209,121	46,740	9,233	—
Non-U.S. government and government agency bonds	149,858	6,906	43,861	32,993	66,098	—
Municipal government and government agency bonds	2,073	—	253	1,341	480	—
Short-term investments	74,093	74,093	—	—	—	—
Subtotal	659,017	89,767	302,869	127,421	127,554	11,407
Asset-backed securities	113,583					
Mortgage-backed securities	21,785					
Total - Investment Grade Portfolio	\$ 794,385	\$ 89,767	\$ 302,869	\$ 127,421	\$ 127,554	\$ 11,407
Total	\$ 2,512,806	\$ 375,935	\$ 632,802	\$ 456,320	\$ 599,891	\$ 11,407

December 31, 2019	Contractual Maturity					
	Fair Value	Due in One Year or Less	Due After One Through Two Years	Due After Three Through Five Years	Due After Five Through Ten Years	Due After Ten Years
(\$ in thousands)						
Non-Investment Grade Portfolio:						
Term loan investments	\$ 1,061,934	\$ 23,683	\$ 289,985	\$ 314,908	\$ 433,358	\$ —
Corporate bonds	213,841	15,746	21,879	113,750	61,933	533
Short-term investments	232,436	232,436	—	—	—	—
Subtotal	1,508,211	271,865	311,864	428,658	495,291	533
Asset-backed securities	190,738					
Mortgage-backed securities	7,706					
Other Investments	30,461					
Equities	125,137					
Total Non-Investment Grade Portfolio	\$ 1,862,253	\$ 271,865	\$ 311,864	\$ 428,658	\$ 495,291	\$ 533
Investment Grade Portfolio:						
Corporate bonds	\$ 158,632	\$ 2,760	\$ 45,676	\$ 54,584	\$ 43,586	\$ 12,026
U.S. government and government agency bonds	285,609	1,490	212,884	41,976	29,259	—
Non-U.S. government and government agency bonds	133,409	6,745	31,443	32,213	63,008	—
Municipal government and government agency bonds	2,184	—	253	1,330	601	—
Short-term investments	96,867	96,867	—	—	—	—
Subtotal	676,701	107,862	290,256	130,103	136,454	12,026
Asset-backed securities	145,433					
Mortgage-backed securities	24,750					
Total - Investment Grade Portfolio	846,884	\$ 107,862	\$ 290,256	\$ 130,103	\$ 136,454	\$ 12,026
Total	\$ 2,709,137	\$ 379,727	\$ 602,120	\$ 558,761	\$ 631,745	\$ 12,559

Actual maturities may differ from contractual maturities because some borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

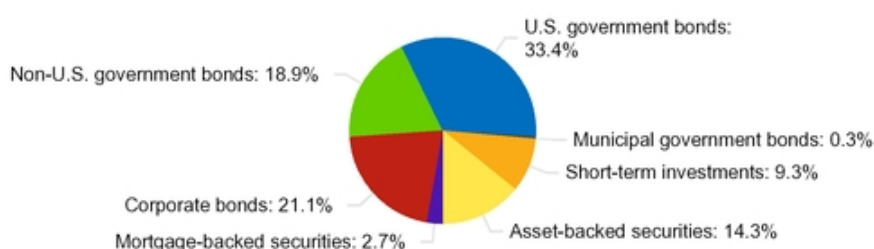
The following chart shows the composition of our non-investment grade and investment grade portfolios as of March 31, 2020:

Non-Investment Grade Portfolio as of March 31, 2020



Total: \$1,718.4 million

Investment Grade Portfolio as of March 31, 2020



Total: \$794.4 million

Liquidity and capital resources

Cash flows

Liquidity is a measure of our ability to access sufficient cash flows to meet the short-term and long-term cash requirements of our business operations. Our most significant source of operating cash flow is from premiums received from our insureds and reinsureds. Our underwriting operations provide liquidity in that premiums are received in advance, sometimes substantially in advance, of the time losses are paid. The period of time from the occurrence of a claim through the settlement of the resulting liability may extend many years into the future. We expect that our liquidity needs, including our anticipated insurance and reinsurance obligations and operating and capital expenditure needs, for at least the next 12 months, will be met by funds generated from underwriting activities and investment income, as well as by our balance of cash, short-term investments, proceeds on the sale or maturity of our investments and our credit facilities. For a discussion of the risks related to the potential future impacts of the COVID-19 global pandemic on our liquidity and capital resources, see Part II, Item 1A, "Risk Factors" in this report.

Our most significant operating cash outflow is for claim payments. Because the payment of claims occurs after the receipt of the premium, often years later, we invest the cash in various fixed income investments that earn interest. We also use cash to pay commissions to brokers, as well as to pay for

ongoing operating expenses such as salaries, rent and taxes, interest expense on our senior notes and dividends on our preference shares. We have reinsurance agreements with Arch and others through which we cede a portion of our business. In purchasing reinsurance, we pay part of our premiums to reinsurers and collect cash back when our reinsurers reimburse us for losses subject to our reinsurance coverage.

The timing of our cash flows from operating activities can vary among periods due to the timing by which payments are made or received. Some of our payments and receipts, including loss settlements and subsequent reinsurance receipts, can be significant, so their timing can influence cash flows from operating activities in any given period.

Sources of liquidity include cash flows from operations, financing arrangements and routine sales of investments. The following table summarizes our cash flows from operating, investing and financing activities for the three months ended March 31, 2020 and 2019:

	Three Months Ended March 31,	
	2020	2019
	(\$ in thousands)	
Cash and cash equivalents provided by (used for):		
Operating activities	\$ 24,575	\$ 70,306
Investing activities	(111,627)	(31,877)
Financing activities	88,184	(45,918)
Effects of exchange rate changes on foreign currency	(6,989)	261
Change in cash and cash equivalents	\$ (5,857)	\$ (7,228)

Results for the three months ended March 31, 2020:

- Cash provided by operating activities for the three months ended March 31, 2020 was lower than the same period in 2019. We continued to generate strong operating cash inflows, primarily driven by our premium receipts exceeding the level of our paid claims, and interest income received.
- Cash used for investing activities for the three months ended March 31, 2020 was higher than the same period in 2019, due to an increase in purchases and a reduction in sales, redemptions and maturities in 2020.
- Cash was provided by financing activities for the three months ended March 31, 2020, rather than being used for financing activities in 2019. During the 2020 first quarter, we increased withdrawals from the secured credit facility and the custodian bank facility, rather than cash used for net repayments of borrowings in the same period for 2019. These withdrawals were driven by our investment strategy related to the timing and use of leverage in managing our non-investment grade portfolio. In addition, we purchased \$2.9 million of our own common shares under our \$50 million share repurchase program during the 2020 first quarter.

Our investments in certain securities and loans may be illiquid due to contractual provisions or may prove to be illiquid in certain investment market conditions. Changes in general economic conditions could have a material adverse effect on the value and liquidity of the investments in our investment portfolios. The COVID-19 global pandemic has severely impacted the financial markets, which has had a material adverse effect on our non-investment grade portfolio, in particular. If we require significant amounts of cash on short notice in excess of our anticipated cash requirements, we may have difficulty selling these investments in a timely manner or may be forced to sell or otherwise liquidate them at unfavorable values.

The primary goals of our asset liability management process are to satisfy insurance liabilities and maintain sufficient liquidity to cover fluctuations in projected liability cash flows, including our debt

service obligations and payment of dividends on our preference shares. We do not explicitly implement an exact cash flow match in each period. However, the substantial degree by which the fair value of our investment portfolios exceeds the expected present value of the net underwriting liabilities, as well as the ongoing cash flow from premiums and contractual principal and interest payments received from our investment portfolios, strengthens our ability to fund the payment of claims and to service our other outstanding obligations without having to sell securities or loans at distressed prices. We believe that, generally, the combination of premium receipts and the expected principal and interest payments produced by our predominantly fixed income investment portfolios will adequately fund future claim payments and other liabilities when due.

Capital resources

In addition to the common shares and preference shares we issued in our initial funding, we have entered into credit facilities to support our business operations. Further, in July 2019, we issued our senior notes and used the net proceeds from the issuance to redeem 76.34% of our then outstanding preference shares, as described in more detail below. We believe that we hold sufficient capital to allow us to continue our business operations and execute our strategy, as well as to comply with all applicable statutory regulations.

We monitor our capital adequacy on a regular basis and will seek to adjust our capital base (up or down) according to the needs of our business. As part of our capital management program, we may seek to raise additional capital or may seek to return capital to our shareholders through share repurchases, cash dividends or other methods (or a combination of such methods). Any such determination will be at the discretion of our board of directors and will be dependent upon our profits, financial requirements and other factors, including legal restrictions, rating agency requirements and such other factors as our board of directors deems relevant.

In the first quarter of 2020, our board of directors authorized a share repurchase program, which allows us to make repurchases of up to \$50 million of our common shares from time to time in open market or privately negotiated transactions. During the quarter, we repurchased 127,744 common shares at an average price of \$22.42 per share for an aggregate cost of \$2.9 million. As of March 31, 2020, approximately \$47.1 million of unused share repurchase capacity remained available under the program. In light of the COVID-19 global pandemic and the uncertain economic outlook, we have temporarily halted repurchases under the program. Including the share repurchases under our initial \$75 million share repurchase program authorized by the board of directors in 2019, we repurchased a total of approximately 2.9 million common shares for an aggregate cost of \$77.9 million, excluding transaction costs between September 2019 and March 31, 2020. Any repurchases under our current share repurchase program will be in accordance with applicable laws, our organizational documents and the applicable terms of our outstanding securities. The timing and amount of the repurchase transactions under the share repurchase program will depend on a variety of factors, including market conditions, the level of future earnings, and rating agency and regulatory considerations. Other than pursuant to our share repurchase program, at the present time, we do not expect to repurchase common shares, declare or pay dividends on our common shares or otherwise return capital to our common shareholders for the foreseeable future.

The following table summarizes our consolidated capital position:

	March 31, 2020		December 31, 2019	
	Amount	% of Total Capital	Amount	% of Total Capital
<i>(\$ in thousands)</i>				
Debt:				
Senior notes	\$ 172,486	21.9%	\$ 172,418	15.7%
Shareholders' equity:				
Preference shares	52,328	6.6%	52,305	4.8%
Shareholders' equity	564,054	71.5%	872,353	79.5%
Total shareholders' equity	616,382	78.1%	924,658	84.3%
Total capital available to Watford	\$ 788,868	100.0%	\$ 1,097,076	100.0%

The future capital requirements of our business will depend on many factors, including our ability to write new business successfully and to establish premium rates and reserves at levels sufficient to cover losses. Our ability to underwrite is largely dependent upon the quality of our claims paying and financial strength ratings as evaluated by independent rating agencies. In particular, we require (1) sufficient capital to maintain our financial strength ratings, as issued by ratings agencies, at a level considered necessary by management to enable our key operating subsidiaries to compete; (2) sufficient capital to enable our underwriting subsidiaries to meet the capital adequacy tests mandated by regulatory agencies in Bermuda, the United States and other key markets; and (3) sufficient letter of credit and other credit facilities to enable Watford Re to post regulatory and commercially required letters of credit and other forms of collateral that are necessary for it to write business. For more information regarding the current status of our ratings, see "-Ratings" below.

To the extent that our existing capital is insufficient to fund our future operating requirements or maintain such ratings, we may need to raise additional funds through financings or limit our growth. However, we can provide no assurance that, if needed, we would be able to obtain additional funds through financing on satisfactory terms or at all. Adverse developments in the financial markets, such as disruptions, uncertainty or volatility in the capital and credit markets may result in realized and unrealized capital losses that could have a material adverse effect on our results of operations, financial position and our businesses, and may also limit our access to capital required to operate our business.

If we are not able to obtain adequate capital, our business, results of operations and financial condition could be adversely affected, which could include, among other things, the following possible outcomes: (1) potential downgrades in the financial strength ratings assigned by ratings agencies to our operating subsidiaries, which could place those operating subsidiaries at a competitive disadvantage compared to higher-rated competitors; (2) reductions in the amount of business that our operating subsidiaries are able to write in order to meet capital adequacy-based tests enforced by regulatory agencies; and (3) any resultant ratings downgrades could, among other things, affect our ability to write business and increase the cost of bank credit and letters of credit. In addition, under certain of the reinsurance agreements assumed by our reinsurance operations, upon the occurrence of a ratings downgrade or other specified triggering event with respect to our reinsurance operations, such as a reduction in surplus by specified amounts during specified periods, our ceding company clients may be provided with certain rights, including, among other things, the right to terminate the subject reinsurance agreement and/or to require that our reinsurance operations post additional collateral.

Prior to August 1, 2019, we had a total of 9,065,200 preference shares that were issued and outstanding and, on August 1, 2019, we redeemed 76.34% of these preference shares as described

below. The holders of our remaining preference shares have the option, at any time on or after June 30, 2034, to redeem their preference shares at the liquidation price of \$25.00 per share. We have the right to redeem any or all of our remaining preference shares at the original purchase price of \$25.00 per share. On June 28, 2019, we completed a direct listing of our preference shares on the Nasdaq Global Select Market. Prior to June 30, 2019, dividends on our preference shares accrued at a fixed rate of 8½% per annum. On June 30, 2019, dividends on our preference shares began accruing at a floating rate. As noted above, on August 1, 2019, we redeemed 6,919,998 of our then outstanding preference shares. The preference shares were redeemed at a total redemption price of \$25.19748 per share, inclusive of all declared and unpaid dividends, with accumulation of any undeclared dividends on or after June 30, 2019.

On July 2, 2019, we completed a private offering of \$175.0 million in aggregate principal amount of our 6.5% senior notes due July 2, 2029. The aggregate principal amount was in line with our then-current limit on Tier 3 capital credit under the BMA's regulatory framework. Interest on our senior notes is paid semi-annually in arrears on each January 2 and July 2, which commenced on January 2, 2020. Affiliates of ACGL purchased \$35.0 million in aggregate principal amount of our senior notes. The \$172.3 million net proceeds from the offering were used to redeem a portion of our outstanding preference shares, as described above.

As a result of the issuance of our senior notes and the redemption of our preference shares, we incur interest expenses and a reduction of preference dividends, with the cumulative effect resulting in substantial savings in our combined interest and preference dividend expense.

In addition to the capital provided by the sale of our common shares, preference shares and senior notes, we may depend on external sources of financing to support our underwriting activities, such as bank credit facilities providing loans and/or letters of credit, as well as additional note issuances. As noted above, additional equity or debt financing, if available at all, may be on terms that are unfavorable to us. In the case of equity financings, dilution to our shareholders could result, and, in any case, such securities might have rights, preferences and privileges that are senior to those of our outstanding securities.

Ratings

Our operating subsidiaries, Watford Re, WICE, WIC and WSIC, each carry a financial strength rating of "A-" (Excellent) from A.M. Best. A.M. Best assigns 16 ratings to insurance companies, which currently range from "A++" (Superior) to "F" (In Liquidation). "A-" (Excellent) is the fourth highest rating issued by A.M. Best. The "A-" (Excellent) rating is assigned to insurers that have, in A.M. Best's opinion, an excellent ability to meet their ongoing obligations to policyholders. Each of our operating subsidiaries also carries a financial strength rating of "A" from KBRA. KBRA assigns 22 ratings to insurance companies, which currently range from "AAA" to "D". The "A" rating, KBRA's sixth highest rating category, is assigned to insurers for which, in KBRA's opinion, the insurer's financial condition is sound and the entity is likely to meet its policyholder obligations under difficult economic, financial and business conditions. These respective ratings are intended to provide an independent opinion of an insurer's ability to meet its obligation to policyholders and neither is an evaluation directed at investors.

The financial strength ratings assigned by A.M. Best and KBRA, respectively, have an impact on the ability of Watford Re to attract reinsurance clients, and also on the ability of our insurance subsidiaries to attract and retain program administrators, agents, brokers and insureds. The A.M. Best "A-" (Excellent) rating and KBRA "A" rating obtained by Watford Re, WICE, WIC, and WSIC are each consistent with our business plan and allow us to actively pursue relationships with the types of cedants, program administrators, agents, brokers and insureds targeted in our marketing plan.

In response to the unrealized, adverse mark-to-market impact on the valuation of our investment portfolios caused by the economic shutdown related to the COVID-19 global pandemic, A.M. Best and KBRA have issued press releases noting potential future rating actions. In particular, on May 1,

2020, A.M. Best announced that it had placed the “A-” financial strength ratings of our operating subsidiaries “under review with negative implications.” In addition, A.M. Best also placed “under review with negative implications” the long-term issuer credit rating of “BBB-” and the long-term issuer credit rating of “BB” on our cumulative contingently-redeemable preference shares. The designation of being “under review with negative implications” indicates that a previously-published rating has the potential for a near-term change (typically within six months) due to a recent event or abrupt change in the financial condition of the entity to which the rating applies. The rating remains under review until A.M. Best is able to determine the implications of the circumstances that facilitated the under review status, before making its final opinion. Similarly, on May 7, 2020, KBRA announced that it had placed on “watch-negative” the “A” insurer financial strength ratings of our operating companies as well as our “BBB+” issuer rating and the credit ratings of our “BBB+” senior unsecured notes and “BBB-” cumulative contingently redeemable preference shares. Placement of a KBRA rating on “watch” status indicates that KBRA believes that there is a meaningful potential for the rating to change in the direction of the watch indicator.

Underwriting, natural and man-made catastrophic events

The broader P&C insurance and reinsurance market in which we operate has long been subject to market cycles. “Soft” markets occur when the supply of insurance capital in a given market or territory is greater than the amount of insurance capital necessary to meet the coverage needs of the insureds in that market. When this occurs, insurance prices tend to decline and policy terms and conditions become more favorable to the insured. Conversely, there are periods when there is not enough insurance capital in the market to meet insureds’ needs, leading to a “hard” market during which insurance prices generally rise and policy terms and conditions become more favorable to the insurer.

In general, notwithstanding the prevailing global economic uncertainty related to the COVID-19 global pandemic, the current insurance and reinsurance market environment overall remains extremely competitive and reflects a prolonged period of low prices and continued pressure to broaden terms and conditions. Over the past several years, the industry has witnessed a gradual rate softening in response to a surplus of industry capital and a number of years of benign catastrophe activity. While the insurance and reinsurance market historically has been subject to pricing and capacity cycles, the overall market has not experienced true cyclicity in the period since the inception of our operations in 2014. However, due to recent property catastrophe losses, along with a higher perceived social inflation, pricing on certain product lines appears to be firming and becoming more attractive on a risk adjusted basis. Nevertheless, in the near term, we believe the COVID-19 global pandemic has created significant areas of uncertainty for the P&C insurance business, with the casualty lines most likely to be adversely affected by the pandemic being professional and medical malpractice liability.

In recent years, there have, however, been certain product lines that have experienced a favorable hardening, such as European motor insurance. The rates for these particular lines have been rising as a result of several years of higher than expected losses, as well as regulatory changes impacting loss costs. As rates and commensurate risk-adjusted returns have risen, we have increased our writings in those lines.

Since the formation of WICE, we have grown our European motor insurance business. Gross premiums written generated by WICE for the three months ended March 31, 2020 and 2019 were \$51.7 million and \$54.8 million, respectively. The majority of such premiums relate to U.K. motor insurance.

In addition, certain “new” product lines, such as mortgage reinsurance (having historically been written by captive insurers allied with primary mortgage insurers or mortgage lenders), are now more widely available due to risk transfer programs initiated over the past few years by the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation. Prior to the COVID-19 global pandemic, we believed the pricing for mortgage reinsurance was attractive on a

risk-adjusted basis. However, we also believe that mortgage insurance may potentially be affected by the COVID-19 global pandemic and have reduced our exposure to this risk.

We target a medium- to long-term, lower volatility underwriting portfolio with tightly managed natural catastrophe exposure in order to reduce the likelihood that our capital and/or liquidity position would be adversely affected by a catastrophe event. We seek to limit our modeled net PML, for property catastrophe exposures for each peak peril and peak zone from a modeled 1-in-250 year occurrence to no more than 10% of our total capital, which is less than most of our principal reinsurance competitors. As of March 31, 2020, our largest modeled peak peril and zone net occurrence PML was 6.7% of our total capital. Our conscious effort to limit our catastrophe exposure is designed to lower the volatility of our overall underwriting portfolio and to provide greater certainty as to future claims-related payout patterns and timing. Our casualty-focused underwriting portfolio's payout pattern is slower than that of most competitors due to the longer tail lines of business we write, and that slower payout pattern provides us with the potential for greater investment income on those premiums.

While we seek to limit our exposure to catastrophic events to a level we believe is acceptable, given the liquidity profile of our underwriting portfolio and investment portfolios, we do assume meaningful aggregate exposures to natural and man-made catastrophic events. Catastrophes can be caused by various events, including hurricanes, floods, windstorms, earthquakes, hailstorms, tornadoes, explosions, severe winter weather, fires, droughts and other natural disasters. Catastrophes can also cause losses in non-property business such as workers' compensation or general liability. In addition to the general nature of the risks inherent in writing property business, we believe that economic and geographic trends affecting insured property, including inflation, property value appreciation and geographic concentration, tend to generally increase the size of losses from catastrophic events over time.

We monitor our exposure to catastrophic events, including earthquake and wind and periodically reevaluate the estimated PML for such exposures. Our estimated PML is determined through the use of modeling techniques, but such estimate does not represent our total potential loss for such exposures. Net PML estimates are net of expected reinsurance recoveries, before income tax and before excess reinsurance reinstatement premiums. Such modeled loss estimates are reflective of the zone indicated and not the entire portfolio. Since hurricanes and windstorms can affect more than one zone and make multiple landfalls, our loss estimates include clash estimates from other zones. Our loss estimates do not represent our maximum exposures and it is highly likely that our actual incurred losses would vary materially from the modeled estimates. There can be no assurances that we will not suffer pre-tax losses greater than 10% of total capital from one or more catastrophic events due to several factors, including the inherent uncertainties in estimating the frequency and severity of such events and the margin of error in making such determinations resulting from potential inaccuracies and inadequacies in the data provided by clients and brokers, the modeling techniques and the application of such techniques or as a result of a decision to change the percentage of shareholders' equity exposed to a single catastrophic event. In addition, our actual losses may increase if our reinsurers fail to meet their obligations to us or the reinsurance protections purchased by us are exhausted or are otherwise unavailable. Depending on business opportunities and the mix of business that may comprise our underwriting portfolio, we may seek to adjust our self-imposed limitations on PML for catastrophe-exposed business.

For more information regarding our current outlook related to the impact of the COVID-19 global pandemic on the insurance and reinsurance industry and our business, see "-Current outlook" above.

Contractual obligations and commitments

Lloyds letter of credit facility

On May 14, 2019, Watford Re renewed its letter of credit facility with Lloyds Bank Corporate Markets Plc, New York Branch (the “Lloyds Facility”). The Lloyds Facility amount is \$100.0 million and was renewed through to May 16, 2020. Under the renewed Lloyds Facility, we may request an increase in the facility amount, up to an aggregate of \$50.0 million. The principal purpose of the Lloyds Facility is to issue, as required, evergreen standby letters of credit in favor of primary insurance or reinsurance counterparties with which we have entered into reinsurance arrangements to ensure that such counterparties are permitted to take credit for reinsurance obtained from us as required under insurance regulations in the United States. The amount of letters of credit issued is driven by, among other things, the timing and payment of catastrophe losses, loss development of existing reserves, the payment pattern of such reserves, the further expansion of our business and the loss experience of such business. When issued, the letters of credit are secured by certificates of deposit or cash. In addition, the Lloyds Facility also requires the maintenance of certain covenants, with which we were in compliance as of March 31, 2020 and December 31, 2019. At such dates, we had approximately \$48.7 million and \$51.0 million, respectively, in restricted assets as collateral for outstanding letters of credit issued from the Lloyds Facility, which were secured by certificates of deposit. These collateral amounts are reflected as short-term investments in our consolidated balance sheets.

Unsecured letter of credit facility

On September 20, 2019, Watford Re signed a 364-day letter of credit agreement with Lloyds Bank Corporate Markets Plc and BMO Capital Markets Corp. (the “Unsecured Facility”). The Unsecured Facility amount is \$100.0 million, and will be automatically extended for a period of one year unless canceled or not renewed by either counterparty prior to expiration. The principal purpose of the Unsecured Facility is to issue, as required, evergreen standby letters of credit in favor of primary insurance or reinsurance counterparties with which we have entered into reinsurance arrangements to ensure that such counterparties are permitted to take credit for reinsurance obtained from us as required under insurance regulations in the United States. The amount of letters of credit issued is driven by, among other things, the timing and payment of catastrophe losses, loss development of existing reserves, the payment pattern of such reserves, the further expansion of our business and the loss experience of such business. The Unsecured Facility requires the maintenance of certain covenants, as well as certain representations and warranties that are customary for facilities of this type. At March 31, 2020 and December 31, 2019, we had \$25.2 million and \$19.3 million, respectively, in outstanding letters of credit issued from the Unsecured Facility, and were in compliance with the Unsecured Facility covenants.

Bank of America secured credit facility

On November 30, 2017, Watford Re amended and restated its \$800.0 million secured credit facility (the “Secured Facility”) with Bank of America, N.A. through Watford Trust, which had originally been entered into in June 2015. Watford Re owns all of the beneficial interests of Watford Trust. The Secured Facility expires on November 30, 2021 and is backed by a portion of Watford Re’s non-investment grade portfolio which has been transferred to Watford Trust and which continues to be managed by HPS pursuant to an investment management agreement between HPS and Watford Trust. The purpose of the Secured Facility is to provide borrowing capacity, including for the purchase of loans, securities and other assets and to distribute cash or any such loans, securities or other assets to Watford Re. Pursuant to this Secured Facility, the bank assigns borrowing or letter of credit capacity (or “advance rate”) for each eligible asset type held in the trust. Under our credit agreement, advance rates range from 100% for cash and 80% for certain first-lien loans to 40% for certain small-issue unsecured bonds.

Borrowings under the Secured Facility may be made at LIBOR or an alternative base rate at our option, in either case plus an applicable margin. The applicable margin varies based on the applicable base rate and, in the case of LIBOR rate borrowings, the currency in which the borrowing is denominated. In addition, the Secured Facility allows for us to issue up to \$400.0 million in evergreen standby letters of credit in favor of primary insurance or reinsurance counterparties with which we have entered into reinsurance arrangements. We pay a fee on each letter of credit equal to the amount available to be drawn under such letter of credit multiplied by an applicable percentage. The applicable percentage varies based on the currency in which the letter of credit is denominated.

The borrowings and outstanding letters of credit from the Secured Facility were as follows:

	March 31, 2020	December 31, 2019
	(\$ in thousands)	
Borrowings to purchase investments	\$ 171,837	\$ 155,537
Borrowings to purchase collateral	328,750	328,750
Total secured credit facility borrowings	500,587	484,287
Outstanding letters of credit	52,533	52,533

The Secured Facility contains various affirmative and negative covenants. As of March 31, 2020 and December 31, 2019, Watford Re was in compliance with all covenants contained in the Secured Facility.

Custodian bank facility

As of March 31, 2020 and December 31, 2019, we had borrowings of \$75.9 million and \$Nil, respectively, from our custodian bank to purchase U.S. dollar denominated securities. We pay interest based on 3-month LIBOR plus a margin and the borrowed amount is payable upon demand.

As of March 31, 2020, the total borrowed amount of \$75.9 million included 0.6 million Euros, or EUR, (U.S. dollar equivalent of \$0.7 million) to purchase EUR-denominated securities. We pay interest based on 3-month LIBOR plus a margin and the borrowed amount is payable upon demand. The foreign exchange gain or loss on revaluation on the non-U.S. dollar-denominated borrowed funds is included as a component of foreign exchange gains (losses) included in the consolidated statements of net income (loss).

The custodian bank requires us to hold cash and investments on deposit, or in an investment account with respect to the borrowed funds. At March 31, 2020 and December 31, 2019, we were required to hold \$108.2 million and \$Nil, respectively, in such deposits and investment accounts.

Senior notes

On July 2, 2019, we completed a private offering of \$175.0 million in aggregate principal amount of our 6.5% senior notes, due July 2, 2029. Interest on the senior notes is paid semi-annually in arrears on each January 2 and July 2, which commenced on January 2, 2020. The senior notes are Watford Holding's senior unsecured and unsubordinated obligations and rank equally with all of the other existing and future obligations of Watford Holdings that are unsecured and unsubordinated. We may redeem the senior notes at any time, in whole or in part, prior to July 2, 2024, at "make-whole" redemption price, subject to BMA requirements. The senior notes are redeemable, in whole or in part, at a redemption price equal to 100% of the principal amount, subject to BMA requirements, at any time after July 2, 2024. At March 31, 2020, the carrying amount of the senior notes was \$172.5 million, presented net of unamortized debt issuance costs of \$2.5 million.

Master confirmation of total return swap transactions

On August 13, 2018, Watford Re executed a Master Confirmation of Total Return Swap Transactions, (the “Master TRS”) with Credit Suisse International, (“CSI”), under the ISDA Master Agreement between Watford Re and CSI dated as of April 24, 2014. Under the Master TRS, we can from time to time execute total return swap transactions referencing loan obligations. The purpose of the Master TRS is to allow us to obtain leveraged exposure to loan obligations in a cash efficient manner. Since each transaction will be confirmed separately, the Master TRS is uncommitted and does not have a maximum facility size. Each confirmed transaction executed under the Master TRS will expire on the earlier of (i) the repayment date of the underlying reference loan or (ii) the date specified in the confirmation, which cannot be later than 360 days after the date of the confirmation, provided that each transaction will automatically extend for a further 360 days unless certain events have occurred. Under the terms of the Master TRS, we are required to post collateral to CSI under our ISDA Credit Support Annex with CSI to support our obligations under each transaction. The collateral will comprise an initial amount, determined on a transaction-by-transaction basis, plus an amount calculated on the basis of the daily mark-to-market value of the transaction. Under each transaction, CSI will pay to us an amount equal to the amounts received by a lender of the specified principal amount under the relevant reference loan and, if the transaction is terminated before the loan is repaid, an amount based on the change in market value of the loan. We have the option to terminate any transaction at will, subject to paying a break fee, and CSI can terminate transactions if certain events occur, including the unavailability of market prices for the relevant loan, CSI being unable to hedge the relevant transaction or certain changes of law or regulation.

Pledged and restricted assets

For the benefit of certain Arch entities and other third parties that cede business to us, we are required to post and maintain collateral to support our potential obligations under reinsurance contracts that we write. This collateral can be in the form of either investment assets held in collateral trust accounts or letters of credit. Under our credit facilities, in order for us to have the bank issue a letter of credit to our reinsurance contract counterparty, we must post investment assets or cash as collateral to the bank. In either case, the amounts remain restricted for the duration of the term of the trust or letter of credit, as applicable. See Note 13, “Commitments and contingencies” in our consolidated financial statements in Part I, Item 1 of this report for further details.

As of March 31, 2020 and December 31, 2019, we held \$2.1 billion and \$2.1 billion, respectively, in pledged assets in support of insurance and reinsurance liabilities as well as to collateralize our credit facilities. Included within total pledged assets, we held \$5.1 million and \$6.4 million, respectively, in deposits with U.S. regulatory authorities.

The following table summarizes our assets pledged as collateral for credit and letter of credit facilities and total return swap transactions, assets held in trust for underwriting transactions and regulatory deposits as of March 31, 2020 and December 31, 2019:

	March 31,	December 31,
	2020	2019
	<i>(\$ in thousands)</i>	
Total investments held in trust as collateral for underwriting transactions and regulatory deposits	\$ 966,077	\$ 1,087,707
Total investments pledged for Secured Facility	888,536	935,132
Total investments pledged for custodian bank	108,225	—
Total investments pledged for Lloyds Facility	48,704	51,047
Total investments pledged for Master TRS	62,091	64,107

Contractual obligations and commitments

The following table illustrates our contractual obligations and commitments by due date as of March 31, 2020 and December 31, 2019:

	Payments Due by Period				
	Total	Less Than One Year	One Year to Less Than Three Years	Three Years to Less Than Five Years	More Than Five Years
<i>(\$ in thousands)</i>					
March 31, 2020					
Estimated gross payments for losses and loss adjustment expenses (1)	\$ 1,300,249	\$ 330,977	\$ 429,372	\$ 228,761	\$ 311,139
Interest payments on senior notes (2)	108,094	11,375	22,750	22,750	51,219
Senior notes (2)	175,000	—	—	—	175,000
Revolving credit agreement borrowings (3)	576,486	576,486	—	—	—
Operating lease obligations	967	283	566	118	—
Total	\$ 2,160,796	\$ 919,121	\$ 452,688	\$ 251,629	\$ 537,358
December 31, 2019					
Estimated gross payments for losses and loss adjustment expenses (1)	\$ 1,263,628	\$ 319,685	\$ 415,163	\$ 223,406	\$ 305,374
Interest payments on senior notes (2)	108,094	11,375	22,750	22,750	51,219
Senior notes (2)	175,000	—	—	—	175,000
Revolving credit agreement borrowings (2)	484,287	484,287	—	—	—
Operating lease obligations	1,038	283	566	189	—
Total	\$ 2,032,047	\$ 815,630	\$ 438,479	\$ 246,345	\$ 531,593

(1) The estimated expected contractual commitments related to the reserves for loss and loss adjustment expenses are presented on a gross basis (not reflecting any corresponding reinsurance recoverable amounts that would be due to us). As of March 31, 2020, the modeled duration of our claims reserves was approximately 4.5 years.

(2) On July 2, 2019 we completed a private offering of \$175.0 million aggregate principal amount of our 6.5% senior notes due July 2, 2029. Interest on the senior notes is paid semi-annually in arrears on each January 2 and July 2, which commenced on January 2, 2020.

(3) Revolving credit agreement borrowings include borrowings from our custodian bank to purchase securities, which is payable on demand. Therefore we have assumed that these payments will be made within one year, but payment may occur over a longer period of time.

Reserves for losses and loss adjustment expenses represent our best estimate of the ultimate cost of settling reported and unreported claims and related expenses. As discussed previously, the estimation of loss and loss expense reserves is based on various complex and subjective judgments. Actual losses and settlement expenses we are ultimately required to pay may deviate, perhaps substantially, from the reserve estimates reflected in our financial statements. Similarly, the timing for payment of our estimated losses is not fixed and is not determinable on an individual or aggregate basis. The assumptions used in estimating the payments due by period are based on industry and peer-group claims payment experience. Due to the uncertainty inherent in the process of estimating the timing of such payments, there is a risk that the amounts paid in any period can be significantly different than the amounts discussed above. Amounts discussed above are gross of anticipated amounts recoverable from reinsurers. Reinsurance balances recoverable on reserves for

losses and loss adjustment expenses are reported separately as assets, instead of being netted with the related liabilities, since having purchased reinsurance does not discharge us of our liability to policyholders. Reinsurance balances recoverable on reserves for paid and unpaid losses and loss adjustment expenses as of March 31, 2020 and December 31, 2019 totaled \$197.5 million and \$171.0 million, respectively.

Inflation

The effects of inflation are considered implicitly in pricing our contracts and policies through the modeled components such as demand surge. Loss reserves are established to recognize likely loss settlements at the date payment is made. Those reserves inherently recognize the effects of inflation. The actual effects of inflation on our results cannot be accurately known, however, until claims are ultimately resolved.

Off-balance sheet arrangements

We are not party to any transaction, agreement or other contractual arrangement to which an entity unconsolidated with us is a party that management believes is reasonably likely to have a current or future effect on our financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that is material to investors.

Item 3. Quantitative and qualitative disclosures about market risk

We believe we are principally exposed to the following types of market risk:

- foreign currency risk;
- interest rate risk;
- credit spread risk;
- credit risk;
- liquidity risk; and
- political risk.

Foreign currency risk

Underwriting contracts and policies

Foreign currency rate risk is the potential change in value, income and cash flow arising from adverse changes in foreign currency exchange rates. We have foreign currency exposure related to non-U.S. dollar denominated contracts and policies. Of our gross premiums written from inception, \$1.5 billion, or 40.0%, were written in currencies other than the U.S. dollar. For these contracts, non-U.S. dollar assets generally offset liabilities in the same non-U.S. dollar currencies resulting in minimal net exposure. As of March 31, 2020 and December 31, 2019, net loss and loss adjustment expense reserves included \$405.3 million and \$413.7 million, respectively, in foreign currencies.

Investments

We are exposed to foreign currency risk through cash and investments in loans and securities denominated in foreign currencies. Foreign currency exchange rate risk is the potential for adverse changes in the U.S. dollar value of investments (long and short) and foreign currency derivative instruments, which we may employ from a risk management perspective, due to a change in the exchange rate of the foreign currency in which cash and financial instruments are denominated. As of March 31, 2020 and December 31, 2019, our total net long exposure to foreign denominated investments represented 13.3% and 11.5% of our total investment portfolios of \$2.5 billion and \$2.7 billion, respectively.

The following table summarizes the net impact that a 10% increase and decrease in the value of the U.S. dollar against select foreign currencies in which we have written contracts and policies would have had on the value of our shareholders' equity as of March 31, 2020 and December 31, 2019:

	March 31, 2020	December 31, 2019
<i>(U.S. dollars in thousands, except per share data)</i>		
Assets, net of insurance liabilities, denominated in foreign currencies, excluding shareholders' equity and derivatives	\$ 90,119	\$ 56,382
Shareholders' equity denominated in foreign currencies (1)	(23,072)	(26,529)
Net assets denominated in foreign currencies	\$ 67,047	\$ 29,853
Pre-tax impact of a hypothetical 10% appreciation of the U.S. dollar against foreign currencies:		
Shareholders' equity	\$ (6,705)	\$ (2,985)
Book value per diluted common share	\$ (0.34)	\$ (0.15)
Pre-tax impact of a hypothetical 10% decline of the U.S. dollar against foreign currencies:		
Shareholders' equity	\$ 6,705	\$ 2,985
Book value per diluted common share	\$ 0.34	\$ 0.15

(1) Represents capital contributions held in the foreign currency of WICE.

Although we generally attempt to match the currency of our projected liabilities with investments in the same currencies, from time to time we may elect to over or underweight one or more currencies, which could increase our exposure to foreign currency fluctuations and increase the volatility of our shareholders' equity. Historical observations indicate a low probability that all foreign currency exchange rates would shift against the U.S. dollar in the same direction and at the same time and, accordingly, the actual effect of foreign currency rate movements may differ materially from the amounts set forth above.

Interest rate risk

Our investment portfolios include interest rate sensitive securities, such as corporate and sovereign debt instruments and asset-backed securities. One key market risk exposure for any debt instrument is interest rate risk. As interest rates rise, the market value of our fixed income portfolio may fall, and the opposite is generally true when interest rates fall. Based on historical observations, there is a low probability that all interest rate yield curves would shift in the same direction at the same time. Furthermore, at times interest rate movements in certain credit sectors exhibit a much lower correlation to changes in U.S. Treasury yields. Accordingly, the actual effect of interest rate movements may differ materially from the amounts set forth in the following tables.

The following table estimates the impact that a 50 basis point and 100 basis point increase or decrease in interest rates would have had on the value of our investment portfolios as of March 31, 2020 and December 31, 2019:

(U.S. dollars in millions)	Interest Rate Shift in Basis Points				
	-100	-50	0	+50	+100
March 31, 2020					
Total fair value	\$ 2,548	\$ 2,532	\$ 2,513	\$ 2,493	\$ 2,476
Change from base	1.4%	0.8%	—%	(0.8)%	(1.5)%
Change in unrealized value	\$ 35	\$ 19	\$ —	\$ (20)	\$ (37)
December 31, 2019					
Total fair value	\$ 2,739	\$ 2,724	\$ 2,709	\$ 2,693	\$ 2,679
Change from base	1.1%	0.6%	—%	(0.6)%	(1.1)%
Change in unrealized value	\$ 30	\$ 15	\$ —	\$ (16)	\$ (30)

Credit spread risk

We invest in credit spread sensitive assets, primarily debt assets. We consider the effect of credit spread movements on the market value of our fixed maturity investments, short-term investments, and certain of our other investments and the corresponding change in market value. As credit spreads widen, the fair value of our fixed income investments falls, and the converse is also true. Based upon historical observations, there is a low probability that credit spreads would change in the same magnitude across asset classes, industries, credit ratings, jurisdictions and individual instruments. Accordingly, the actual effect of credit spread movements may differ materially from the amounts set forth in the following tables.

The following table summarizes the effect that an immediate, parallel shift in credit spreads in a static interest rate environment would have had on the value of our investment portfolios as of March 31, 2020 and December 31, 2019:

(U.S. dollars in millions)	Percentage Shift in Credit Spreads				
	-50%	-10%	0	+10%	+50%
March 31, 2020					
Total fair value	\$ 2,748	\$ 2,559	\$ 2,513	\$ 2,466	\$ 2,283
Change from base	9.4%	1.8%	—%	(1.9)%	(9.2)%
Change in unrealized value	\$ 235	\$ 46	\$ —	\$ (47)	\$ (230)
December 31, 2019					
Total fair value	\$ 2,836	\$ 2,735	\$ 2,709	\$ 2,681	\$ 2,569
Change from base	4.7%	1.0%	—%	(1.0)%	(5.2)%
Change in unrealized value	\$ 127	\$ 26	\$ —	\$ (28)	\$ (140)

Credit risk

Underwriting contracts and policies

We are exposed to credit risk from our clients relating to premiums receivable under our contracts and policies, and the possibility that counterparties may default on their obligations to us. The risk of counterparty default is partially mitigated by the fact that any amount owed to us from an

insurance or reinsurance counterparty would be netted against any losses we would pay in the future. We monitor the collectability of these premiums on a regular basis.

Investments

Our investment strategy is to invest primarily in the debt obligations of non-investment grade corporate issuers. We rely upon our Investment Managers to invest our funds in debt instruments that provide an attractive risk-adjusted return, but the value we ultimately receive from these debt instruments is dependent upon the performance of the issuers of such obligations. In addition, the securities and cash in our investment portfolios are held with several custodians and prime brokers, subjecting us to the related credit risk from the possibility that one or more of them may default on their obligations to us. Our Investment Managers regularly monitor the concentration of credit risk with each broker and if necessary, transfer cash or securities among brokers to diversify and mitigate our credit risk.

Liquidity risk

Certain of our investments are, or may become, illiquid. Disruptions in the credit markets may materially affect the liquidity of certain investments including our Level 3 (non-quoted) assets, which, as of March 31, 2020 and December 31, 2019, represented 5.9% and 5.4% of our total investments, respectively. If we require significant amounts of cash on short notice in excess of anticipated cash requirements, which could include the payment of claims expenses or to satisfy a requirement of rating agencies in a period of market illiquidity, certain of our investments may be difficult to sell in a timely manner and may have to be sold or otherwise liquidated for less than what may otherwise have been possible under normal market conditions.

Political risk

We are exposed to political risk to the extent that we underwrite business from entities located in foreign markets; we operate through subsidiaries located in Bermuda, the United States and Gibraltar, and to the extent that HPS or AIM trade securities or assets that are originated, listed or traded in various U.S. and foreign markets. The governments in any of these jurisdictions could impose restrictions, regulations or other measures which may have a material impact on our investment strategy, the value of our investments and our underwriting operations.

We do not currently write political risk coverage in our insurance or reinsurance contracts; however, changes in government law and regulation may impact our underwriting operations.

Item 4. Controls and procedures

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in the reports we file under the Securities Exchange Act on 1934, as amended, or the Exchange Act, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required financial disclosure.

As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures defined under Rules 13a-15(e) and 15d-15(e) under the Exchange Act. Based upon this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective.

Changes in Internal Controls over Financial Reporting

There were no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the fiscal quarter ended March 31, 2020 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. We have not experienced any material impact to our internal controls over financial reporting despite the fact that most employees of the Company and of our service providers have had to work from home during the COVID-19 global pandemic, though we will continue to assess the impact on the design and operating effectiveness of our internal controls.

Inherent Limitations on Effectiveness of Controls

The effectiveness of any system of controls and procedures is subject to certain limitations, and, as a result, there can be no assurance that our controls and procedures will detect all errors or fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system will be attained.

Part II. Other information

Item 1. Legal proceedings

We, in common with the insurance industry in general, are subject to litigation and arbitration in the normal course of our business. As of March 31, 2020, we were not a party to any litigation or arbitration which is expected by management to have a material adverse effect on our results of operations and financial condition and liquidity.

Item 1A. Risk factors

Investing in our securities involves risks. For a discussion of the these potential risks or uncertainties, please see Part I—Item 1A—“Risk Factors” and Part II—Item 7—“Management’s Discussion and Analysis of Financial Condition and Results of Operations” in our Annual Report on Form 10-K for the year ending December 31, 2019 filed with the SEC (or our 2019 Annual Report), and Part I—Item 2—“Management’s Discussion and Analysis of Financial Condition and Results of Operations” in this report, in each case as updated by our subsequent periodic filings with the SEC.

Other than as described below, there have been no material changes from the risk factors previously disclosed in Part I—Item 1A, “Risk Factors” of our 2019 Annual Report.

The impact of the COVID-19 global pandemic and related risks could materially affect our results of operations, financial position and/or liquidity.

The continuing, global pandemic related to the novel coronavirus COVID-19 has impacted the global economy, financial markets and our results of operations. In addition, the COVID-19 global pandemic could materially disrupt the business operations of Arch, HPS or other third parties with whom we interact. Because of the size and breadth of this pandemic, all of the direct and indirect consequences of the COVID-19 global pandemic are not yet known and may not emerge for some time.

The pandemic could have a significant effect on our business, results of operations, and current and future financial performance. We may experience higher levels of loss and claims activity in certain lines of business and our premiums written and earned could also be adversely affected by a suppression of global commercial activity that results in a reduction in insurable assets and other exposure. Conditions of the financial markets resulting from the COVID-19 global pandemic also have had and may continue to have a negative effect on the value and quality of the assets we hold within our investment portfolios, thereby adversely affecting our investment income and increasing our credit and related risk. Certain lines of our business may require additional forms of collateral in the event of a decline in the fair value of investments and benchmarks to which those repayment mechanisms are linked. The continued impacts of the pandemic to the financial markets may also adversely affect our ability to fund through public or private equity offerings, debt financings, and through other means at acceptable terms. In addition, in connection with our pending acquisition of Axeria IARD, we are also evaluating Axeria’s potential exposure to COVID-19 related losses.

In particular, disruption in the financial markets related to the COVID-19 global pandemic has contributed to net realized and unrealized losses, due to the impact of changes in fair value on our non-investment grade investment portfolio, and, to a lesser extent, our investment grade investment portfolio. Our investment portfolios may be adversely impacted by ratings downgrades, increased bankruptcies and credit spread widening in distressed industries, such as energy, gaming, lodging and leisure, autos, airlines and retail. Our investment portfolios also include mortgage-backed securities, which could be adversely impacted by declines in real estate valuations and/or financial market disruption, including a heightened collection risk on the underlying mortgages and

on rent receivables. Further disruptions in global financial markets due to the continuing impact of COVID-19 could result in additional net realized and unrealized investment losses, including potential impairments in our investment portfolios. In addition, declines in fixed income yields would result in decreases in net investment income from future investment activity, including re-investments.

For further discussion of certain of the risks related to our underwriting and investment portfolios, see “Claims for natural catastrophic events or unanticipated losses from war, pandemic, terrorism and political instability could cause large losses and substantial volatility in our results of operations and could have a material adverse effect on our financial position and results of operations,” “Emerging claim and coverage issues may adversely affect our business,” “The performance of our investments is highly dependent upon conditions in the global economy or financial markets that are outside of our Investment Managers’ control and can be difficult to predict,” and “The determination of the amount of allowances and impairments taken on our investments is highly subjective and could materially impact our results of operations or financial position.” included in Part I—Item 1A—“Risk Factors” in our 2019 Form 10-K.

Governmental, and regulatory actions in response to the COVID-19 global pandemic may adversely affect our financial performance and our ability to conduct our businesses as we have in the past.

Federal, state and local government actions in the United States and other countries where we do business to address and mitigate the impact of COVID-19 may adversely affect us. For example, we are potentially subject to legislative and/or regulatory action that seeks to retroactively mandate coverage for losses which our insurance policies were not designed or priced to cover. Currently, in some states there is proposed legislation to require insurers to cover business interruption claims irrespective of terms, exclusions or other conditions included in the policies that would otherwise preclude coverage. In addition, a number of states have instituted, and other states are considering instituting, changes designed to effectively expand workers’ compensation coverage by creating presumptions of compensability of claims for certain types of workers. Regulatory restrictions or requirements could also impact pricing, risk selection and our rights and obligations with respect to our policies and insureds, including our ability to cancel policies or our right to collect premiums. At least one state regulator has issued an order requiring insurers to issue partial premium refunds, and regulators in other states could take similar actions. Many insurers, including us, have also voluntarily provided, and may further provide, partial premium refunds to their customers. It is also possible that changes in economic conditions and steps taken by federal, state and local governments in response to the COVID-19 global pandemic could require an increase in taxes at the federal, state and local levels, which could adversely impact our results of operations. In addition, in connection with our pending acquisition of Axeria IARD, we are also evaluating the potential impact such governmental actions, restrictions and requirements could have on Axeria’s business.

The disruption and other effects caused by the COVID-19 global pandemic could adversely affect our business operations, financial performance and results.

To protect our employees and in response to the global and regional restrictions on interpersonal contact and travel because of the COVID-19 global pandemic, our work force is working remotely, placing increased demands on our IT systems. Remote working arrangements may increase the risk of cyber-security attacks or data security incidents. While we believe we have continued to conduct our business effectively, there is no assurance that our ability to continue to function in this new environment will not be adversely affected by an extended period of limited access to our physical facilities or by other developments such as an extended disruption to our systems that support our remote work capability. We also depend on Arch, HPS and other third-party platforms and infrastructure to operate our business and provide certain of our products and services, and such third-party infrastructures face similar risks. In addition, the continuation of the COVID-19 global pandemic may continue to adversely affect our business operations, including our ability to carry on business development activities and unavailability of employees due to illness or quarantines,

among others. In addition, in connection with our pending acquisition of Axeria IARD, we are also evaluating the potential impact of such disruptions and restrictions could have on Axeria's operations. For a further discussion, see "We depend on our ability to maintain effective operating procedures, and our operational structure remains under development." "Any acquisitions, growth or expansion of our operations may expose us to risks." and "Technology breaches or failures, including those resulting from a cyberattack on us or our service providers and program administrators, could disrupt or otherwise negatively impact our business." included in Part I-Item 1A-"Risk Factors" in our 2019 Form 10-K.

As a result of the above risks, the COVID-19 global pandemic could materially and adversely impact our results of operations, financial position and/or liquidity.

A ratings downgrade or other negative action by a rating agency could materially affect our business, financial condition and results of operations.

Various rating agencies review the financial performance and condition of insurance and reinsurance companies, including our operating subsidiaries, and publish their financial strength ratings as indicators of an insurer's or reinsurer's ability to fulfill its contractual obligations. These ratings are important to maintaining public confidence in our insurance and reinsurance products. A downgrade or other negative action by a rating agency with respect to the financial strength ratings of our operating subsidiaries could negatively affect us by limiting or restricting the ability of our operating subsidiaries to pay dividends to us and reducing our revenues by adversely affecting our ability to write insurance and reinsurance business.

Rating agencies also publish credit ratings for us. Credit ratings are indicators of a debt issuer's ability to meet the terms of debt obligations in a timely manner. These ratings are important to our overall ability to access certain types of capital. Actual or anticipated downgrades in our credit ratings, or an announcement that our ratings are under further review for a downgrade, could potentially have a negative effect on our financial condition and results of operations. Such an event could limit our access to capital markets, increase the cost of debt, or impair our ability to raise capital to refinance maturing debt obligations, thereby potentially limiting our capacity to support growth at our operating subsidiaries or making it more difficult to maintain or improve the current financial strength ratings of our operating subsidiaries.

In particular, in May 2020, A.M. Best announced that it had placed the financial strength ratings of our operating subsidiaries and our credit ratings under review with negative implications, and KBRA similarly announced that it had placed the financial strength ratings of our operating companies and our credit ratings on watch status. For more information, see Part I, Item 2. "Management's Discussion and Analysis of Financial Condition and Results of Operations-Financial Condition, Liquidity and Capital Resources- Liquidity and Capital Resources-Ratings" in this report.

Ratings reflect only a rating agency's views and are not recommendations to buy, sell or hold our securities. Rating agencies assign ratings based upon several factors. While most of the factors relate to the rated company, some of the factors relate to the views of the rating agency, general economic conditions and circumstances outside the rated company's control. In addition, rating agencies use various models and formulas to assess the strength of a rated company, and from time to time rating agencies have, in their discretion, altered the models. Changes to the models could impact a rating agency's judgment of the rating to be assigned to the rated company. There can be no assurance that our current financial strength and credit ratings will remain in effect for any given period of time, particularly in light of the recent announcements by A.M. Best and KBRA, or that these ratings will not be lowered, suspended or withdrawn entirely by the rating agencies. We cannot predict what actions A.M. Best, KBRA or other rating agencies may take, or what actions we may take in response to the actions of the rating agencies, which could negatively affect our business, financial condition and results of operations.

Item 2. Unregistered sales of equity securities and use of proceeds

The following table summarizes our purchases of common shares for the 2020 first quarter:

Period	Issuer Purchases of Common Shares			
	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares that May Yet be Purchased Under the Plan or Program (1)
1/1/2020 - 1/31/2020	—	\$ —	—	\$ —
2/1/2020 - 2/29/2020	—	—	—	—
3/1/2020 - 3/31/2020	127,744	22.42	127,744	47,136
Total	127,744	\$ 22.42	127,744	\$ 47,136

(1) In the first quarter of 2020, our board of directors authorized a new share repurchase program, under which we may repurchase up to \$50 million of our common shares.

Item 3. Defaults upon senior securities

None.

Item 4. Mine safety disclosures

None.

Item 5. Other information

None.

Item 6. Exhibit index

Exhibit Number	Exhibit Description	Incorporated by Reference			Filed Herewith
		Form	Original Exhibit Number	Date Filed	
10.42	Employment Agreement between Watford Holdings Ltd. and Liz Cunningham, dated October 3, 2019.				X
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002				X
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002				X
32.1	Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002				X
32.2	Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002				X
101	The following financial information from Watford Holdings Ltd.'s Quarterly Report for the quarter ended March 31, 2020 formatted in XBRL: (i) Consolidated Balance Sheets at March 31, 2020 and December 31, 2019; (ii) Consolidated Statements of Income for the three months ended March 31, 2020 and 2019; (iii) Consolidated Statements of Comprehensive Income for the three months ended March 31, 2020 and 2019; (iv) Consolidated Statements of Changes in Shareholders' Equity for the three months ended March 31, 2020 and 2019; (v) Consolidated Statements of Cash Flows for the three months ended March 31, 2020 and 2019; and (vi) Notes to Consolidated Financial Statements.				

Signatures

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

WATFORD HOLDINGS LTD.

(REGISTRANT)

Date: May 11, 2020

/s/ Jonathan D. Levy

Jonathan D. Levy, Chief Executive Officer

Date: May 11, 2020

/s/ Robert L. Hawley

Robert L. Hawley, Chief Financial Officer

EMPLOYMENT AGREEMENT

EMPLOYMENT AGREEMENT ("**Agreement**"), dated as of October 3, 2019, between Watford Holdings Ltd., a Bermuda corporation (the "**Company**"), and Liz Cunningham (the "**Executive**" and together with Company, the "**Parties**").

The parties hereto agree as follows:

ARTICLE 1 DEFINITIONS

Section 1.01. **Definitions.** For purposes of this Agreement, the following terms have the meanings set forth below:

"**Accounting Firm**" has the meaning set forth in Section 12.10(b).

"**Affiliate**" means any Person, in which the Company owns, directly or indirectly, (i) in the case of a corporation, securities representing 50% or more of the total voting power or value of all the then outstanding securities of such corporation, or (ii) in the case of a partnership, limited liability company, association or other business entity, 50% or more of the partnership or other similar ownership interest of such business entity. Notwithstanding the foregoing, for purposes of Article 9, the term "Affiliate" shall not include any noninsurance business of an acquirer of the Company or of any Affiliate of such acquirer.

"**Annual Bonus**" has the meaning set forth in Section 4.02(a).

"**Annual RSU Award**" has the meaning set forth in Section 4.03(b).

"**Base Salary**" has the meaning set forth in Section 4.01.

"**Board**" means the Board of Directors of the Company.

"**Cause**" means (a) theft or embezzlement by the Executive with respect to the Company or its Affiliates; (b) willful disregard or gross negligence in the performance of the Executive's duties; (c) the Executive's conviction of any felony or any crime involving moral turpitude; (d) willful or prolonged absence from work by the Executive (other than by reason of Permanent Disability due to physical or mental illness) or failure, neglect or refusal by the Executive to perform her duties and responsibilities; (e) continued and habitual use of alcohol by the Executive to an extent which materially impairs the Executive's performance of her duties; (f) the Executive's use of illegal drugs; (g) the Executive's failure to use her best efforts to obtain, maintain or renew the work permit described in Section 3.02 below; or (h) the material breach by the Executive of any of the covenants contained in this Agreement. Cause shall not exist with respect to items (b), (d), (e), (f), (g) or (h) (other than, in the case of item (h), a breach of Section 11.01) unless and until Executive has been given written notice specifying in detail the circumstances giving rise to the alleged Cause, and the Executive shall have failed, within thirty (30) days after such notice, to remedy (or, if such alleged cause cannot be remedied within thirty (30) days, diligently commenced to remedy) the alleged Cause.

"Change in Control" means:

(a) the acquisition (whether by purchase, merger, consolidation, combination or other similar transaction) by any Person of beneficial ownership (within the meaning of Rule 13d-3 promulgated under the Exchange Act) of more than 33 1/3% (on a fully diluted basis) of either (i) the then outstanding shares of Common Shares, taking into account as outstanding for this purpose such Common Shares issuable upon the exercise of options or warrants, the conversion of convertible stock or debt, and the exercise of any similar right to acquire such Common Shares; or (ii) the combined voting power of the then outstanding voting securities of the Company entitled to vote generally in the election of directors; provided, however, that for purposes of this Agreement the following acquisitions shall not constitute a Change in Control: (A) any acquisition by the Company or any Affiliate; or (B) any acquisition by any employee benefit plan sponsored or maintained by the Company or any Affiliate;

(b) during any period of twelve (12) months, individuals who, at the beginning of such period, constitute the Board (the "**Incumbent Directors**") cease for any reason to constitute at least a majority of the Board; provided, that any Person becoming a director subsequent to the date of this Agreement, whose election or nomination for election was approved by a vote of at least two-thirds of the Incumbent Directors then on the Board (either by a specific vote or by approval of the proxy statement of the Company in which such person is named as a nominee for director, without written objection to such nomination) shall be an Incumbent Director; provided, however, that no individual initially elected or nominated as a director of the Company as a result of an actual or threatened election contest, as such terms are used in Rule 14a-12 of Regulation 14A promulgated under the Exchange Act, with respect to directors or as a result of any other actual or threatened solicitation of proxies or consents by or on behalf of any person other than the Board shall be deemed to be an Incumbent Director;

(c) the sale, transfer or other disposition of all or substantially all of the assets of the Company and its Affiliates to any Person that is not an Affiliate of the Company; or

(d) there is consummated a merger or amalgamation or consolidation involving the Company or any direct or indirect subsidiary with any other corporation or other entity, other than (i) a merger or amalgamation or consolidation which results in (A) the voting securities of the Company outstanding immediately prior to such merger or amalgamation or consolidation continuing to represent (either by remaining outstanding or by being converted into voting securities of the surviving entity or any parent thereof), 66 2/3% or more of the combined voting power of the securities of the Company or such surviving entity or any parent thereof outstanding immediately after such merger or amalgamation or consolidation or (ii) a merger or amalgamation or consolidation effected to implement a recapitalization of the Company (or similar transaction) in which no Person is or becomes the beneficial owner, directly or indirectly, of securities of the Company (not including in the securities beneficially owned by such Person any securities acquired directly from the Company or its Affiliates) representing 33 1/3% or more of the combined voting power of the Company's then outstanding securities.

"Code" has the meaning set forth in Section 12.09.

"**Commencement Date**" has the meaning set forth in Section 2.01.

"**Common Shares**" means the Common Shares of the Company, with an initial par value of \$0.01 per share, and includes a fraction of a Common Share.

"**Confidential Information**" means information that is not generally known to the public and that was or is used, developed or obtained by the Company or its Affiliates in connection with their business. It shall not include information (a) required to be disclosed by court, stock exchange requirement, administrative order or similar official request, or called for in a subpoena or discovery request regular on its face, (b) lawfully obtainable from other sources or which is in the public domain through no fault of the Executive; or (c) the disclosure of which is consented to in writing by the Company.

"**Date of Termination**" has the meaning set forth in Section 5.06.

"**Disability Period**" has the meaning set forth in the definition of "Permanent Disability."

"**Employment Period**" has the meaning set forth in Section 2.01.

"**Good Reason**" means, without the Executive's written consent and subject to the timely notice requirement and the Company's opportunity to cure set forth in Section 5.05 below, (a) the assignment to the Executive of any duties materially inconsistent with the Executive's then status as an executive officer of the Company or a substantial adverse alteration in the nature of the Executive's responsibilities; (b) a material reduction by the Company in the Executive's Base Salary, Target Bonus or Annual RSU Award; (c) the relocation of the Executive's principal place of employment outside of Bermuda; or (d) any material breach by the Company of the provisions contained in this Agreement.

"**Intellectual Property**" has the meaning set forth in Section 7.01.

"**Justified Termination**" has the meaning set forth in Section 5.03.

"**Noncompetition Notice**" has the meaning set forth in Section 9.01(a).

"**Notice of Termination**" has the meaning set forth in Section 5.05.

"**Performance-Based RSUs**" has the meaning set forth in Section 4.03(b).

"**Permanent Disability**" means those circumstances where the Executive is unable to continue to perform the usual customary duties of her assigned job in accordance with the provisions of this Agreement for a period of six (6) months in any twelve (12) month period (the "**Disability Period**") because of physical, mental or emotional incapacity resulting from injury, sickness or disease. Until the termination of the Employment Period by reason of the Executive's Permanent Disability, the Company shall pay to the Executive \$15,000 per month, reduced by any amounts she receives under any disability plan maintained by the Company at such time. The Company shall notify the Executive in writing of any finding of Permanent Disability on its part at the end of the Disability Period. If the Company and the Executive are unable to agree whether she is so disabled, the question shall be decided by a physician designated by the Executive and approved

by the Company. The determination of the panel shall be final and binding upon the parties with the costs of the physician to be paid by the Company.

"**Person**" means an individual, a partnership, a corporation, a limited liability company, an association, a joint stock company, an estate, a trust, a joint venture, an unincorporated organization or a governmental entity or any department, agency or political subdivision thereof.

"**Proceeding**" has the meaning set forth in Section 4.06.

"**Reimbursable Expenses**" has the meaning set forth in Section 4.05.

"**Restricted Period**" has the meaning set forth in Section 9.01.

"**Retirement Age**" means the later of (i) the Executive's 55th birthday or (ii) the date on which the Executive has completed five (5) continuous years of service with the Company or any of its Affiliates. For purposes of this definition, the Executive is credited with one year of service after completion of each full 12-month period of employment with the Company or its Affiliates as determined by the Company.

"**Signing Bonus**" has the meaning set forth in Section 4.02(b).

"**Severance Period**" has the meaning set forth in Section 5.02.

"**Stock Incentive Plan**" means the Watford Holdings Ltd. 2018 Stock Incentive Plan.

"**Target Bonus**" has the meaning set forth in Section 4.02(a).

"**Time-Based RSUs**" has the meaning set forth in Section 4.03(b).

"**Unjustified Termination**" has the meaning set forth in Section 5.02.

ARTICLE 2 EMPLOYMENT

Section 2.01. **Employment.** The Company shall employ the Executive, and the Executive shall accept such employment with the Company, for the period beginning on January 2, 2020 (the "**Commencement Date**") and ending as provided in Section 5.01 (such period, the "**Employment Period**").

ARTICLE 3 POSITION AND DUTIES

Section 3.01. **Position and Duties.** During the Employment Period, the Executive shall serve as Chief Risk Officer of the Company and shall have such responsibilities, powers and duties as may from time to time be prescribed by the Chief Executive Officer of the Company; **provided that** such responsibilities, powers and duties are substantially consistent with those customarily assigned to individuals serving in such positions at comparable companies or as may be reasonably required by the conduct of the business of the Company. During the Employment Period the Executive shall devote substantially all of her working time and efforts to the business and affairs

of the Company. The Executive shall not directly or indirectly render any services of a business, commercial or professional nature to any other person or for-profit organization not related to the business of the Company or its Affiliates, whether for compensation or otherwise, without the prior written consent of the Company.

Section 3.02. **Work Permits.** The Executive shall use her reasonable best efforts to obtain, maintain and renew a suitable (for the purposes of the Executive's contemplated employment by the Company) work permit by the Bermuda government authorities and any other permits required by any Bermuda government authority. The Company shall be responsible for permit fees, and all other expenses, including legal expenses, in connection with obtaining and maintaining such work permit.

Section 3.03. **Work Location.** While employed by the Company hereunder, the Executive shall perform her duties (when not traveling or engaged elsewhere in the performance of her duties) at the offices of the Company in Bermuda. The Executive shall travel to such places on the business of the Company in such manner and on such occasions as the Company may from time to time reasonably require.

Section 3.04. **Relocation.** Upon the termination of Executive's employment for any reason, the Company shall reimburse the Executive up to a maximum of \$25,000 for reasonable expenses incurred by her for the cost of relocating all of her household items to the United Kingdom and airfare for the Executive and her family to return to the United Kingdom, in each case, subject to the Company's requirements with respect to reporting and documentation of such expenses; **provided, however, that** any such expenses must be incurred by the Executive not later than the last day of the calendar year following the calendar year in which the Executive's "separation from service" (within the meaning of Treas. Reg. Section 1.409A-1(h)) with the Company occurs, and any such reimbursement shall be made promptly upon presentation by the Executive to the Company of the required documentation and, in all events, no later than the last day of the second calendar year following the calendar year in which the Executive's "separation from service" with the Company occurs.

ARTICLE 4 BASE SALARY AND BENEFITS

Section 4.01. **Base Salary.** During the Employment Period, the Executive's base salary will be \$310,000 per annum (the "**Base Salary**"). The Base Salary will be payable monthly on the 15th day of each month, two weeks in arrears and two weeks in advance. Annually during the Employment Period, the Company shall review with the Executive her job performance and compensation. The amount of the Executive's Base Salary shall be reviewed annually by the Board but shall not be reduced without the written consent of the Executive. Normal hours of employment are 8:30 a.m. to 5:00 p.m., Monday to Friday. The Executive's salary has been computed to reflect that her regular duties are likely, from time to time, to require more than the normal hours per week and the Executive shall not be entitled to receive any additional remuneration for work outside normal hours.

Section 4.02. **Bonuses.**

(a) **Annual Bonus.** In addition to the Base Salary, during the Employment Period, the Executive shall be eligible to receive an annual bonus (the "**Annual Bonus**") based on a target annual bonus (the "**Target Bonus**," which term shall include any subsequent adjustments thereto) of an amount equal to 50% of the Base Salary. Such Annual Bonus shall be subject to the terms and conditions of the Company's annual bonus plan.

(b) **Signing Bonus.** The Company shall pay the Executive a lump sum cash signing bonus of \$100,000 (the "**Signing Bonus**") within 30 days following the Commencement Date; **provided, however, that**, the Executive shall repay to the company the full amount of the Signing Bonus if, prior to the one-year anniversary of the Commencement Date, the Executive terminates her employment without Good Reason or is terminated by the Company for Cause.

Section 4.03. **Equity Compensation.** Each calendar year during the Employment Period commencing on or after January 1, 2020, the Executive shall be eligible to receive a grant of Company restricted stock units (the "**Annual RSU Award**"). The Common Shares subject to each Annual RSU Award shall have a target value on the date of grant equal to \$150,000. The actual value of each Annual RSU Award on the date of grant shall be based on an evaluation of the Executive's individual performance by the Company's Compensation Committee. One-half of each Annual RSU Award (the "**Time-Based RSUs**") shall vest ratably on an annual basis on the first three anniversaries of the grant date of such Annual RSU Award. One-half of each Annual RSU Award (the "**Performance-Based RSUs**") shall vest on the third anniversary of the grant date of such Annual RSU Award based on the achievement of certain Company performance goals. The terms and conditions of an Annual RSU Award shall be set forth in a Restricted Stock Unit Agreement entered into between the Company and the Executive and shall be subject to the terms and provisions of the Stock Incentive Plan.

Section 4.04. **Benefits.** In addition to the Base Salary, and any bonuses payable to the Executive pursuant to this Agreement, the Executive shall be entitled to the following benefits during the Employment Period:

(a) such major medical, life insurance and disability insurance coverage as is, or may during the Employment Period, be provided generally for other senior executive officers of the Company as set forth from time to time in the applicable plan documents;

(b) in addition to the usual public holidays and ten (10) paid days off for sick leave, a maximum of four (4) weeks of paid vacation annually during the term of the Employment Period (Section 11 of the Bermuda Employment Act 2000 shall otherwise not apply to the Executive's employment hereunder);

(c) benefits under any plan or arrangement available generally for the senior executive officers of the Company, subject to and consistent with the terms and conditions and overall administration of such plans as set forth from time to time in the applicable plan documents;

(d) for each calendar year during which the Executive is employed by the Company for any part thereof, payment by the Company of the reasonable cost of preparation of annual tax returns and associated tax planning on a basis no less favorable than such arrangements provided to similarly situated senior executives residing in Bermuda, and the cost paid by the Company under this Section 4.04(d) for each such calendar year shall be paid by the Company promptly upon presentation by the Executive to the Company of the required documentation and, in all events, not later than the end of the following calendar year;

(e) a housing allowance for housing in Bermuda of \$6,500 per month, less all applicable withholdings, payable monthly on the 15th day of each month, two weeks in arrears and two weeks in advance;

(f) payment by the Company annually of the cost of two (2) roundtrip flights between Bermuda and the United Kingdom for the Executive and the Executive's immediate family members;

(g) the Company shall pay the employee portion of applicable payroll and social security taxes imposed by the government of Bermuda;

(h) for any period during which the Executive is not a resident of the United Kingdom, the Company shall reimburse the Executive for any taxes imposed on the Executive by the United Kingdom by reason of the Executive's performance of services for the Company; and

(i) the Company shall reimburse the Executive for any income taxes incurred by the Executive as a result of any payment from or benefit provided by the Company pursuant to this Section 4.04 (including taxes imposed on the reimbursement payment itself). Any such reimbursement payments shall be made no later than twelve (12) months following the end of the fiscal year in which the related expense is incurred.

Section 4.05. **Expenses.** The Company shall reimburse the Executive for all reasonable expenses incurred by her in the course of performing her duties under this Agreement which are consistent with the Company's policies in effect from time to time with respect to travel, entertainment and other business expenses ("**Reimbursable Expenses**"), subject to the Company's requirements with respect to reporting and documentation of expenses. Any such reimbursement

payments shall be made promptly, but in no event later than twelve (12) months following the end of the fiscal year in which the related expense is incurred.

Section 4.06. **Indemnification; D&O Insurance.** The Company agrees that if the Executive is made a party, or is threatened to be made a party, to any pending or threatened action, suit or proceeding, whether civil, criminal, administrative or investigative (each, a "**Proceeding**"), by reason of the fact that she is or was a director, officer or employee of the Company or is or was serving at the request of the Company as a director, officer, member, employee or agent of another corporation, partnership, joint venture, trust or other enterprise, including service with respect to employee benefit plans, the Executive shall be indemnified and held harmless by the Company to the fullest extent permitted or authorized by applicable law and the company's certificate of incorporation or bylaws, against all cost, expense, liability and loss reasonably incurred or suffered by the Executive in connection therewith, including, without limitation, attorneys' fees and disbursements and judgments, and the Company shall advance expenses in connection therewith, to the fullest extent permitted or authorized by applicable law and the Company's certificate of incorporation or bylaws. The Company shall cover the Executive as an insured under any contract of directors and officers liability insurance that is in effect from time to time covering officers and members of the Board. The provisions of this Section 4.06 shall survive any expiration or termination of the Employment Period and continue in effect for so long as the Executive is subject to liability for any of the Executive's acts and omissions to act occurring during her employment or other service as an officer of any entity or member of any board performed at the request of the Company.

ARTICLE 5 TERM AND TERMINATION

Section 5.01. **Term.** The Employment Period will terminate on the third anniversary of the Commencement Date; **provided that** (a) the Employment Period shall terminate prior to such date upon the Executive's death or Permanent Disability, and (b) the Employment Period may be terminated by the Company or by the Executive for any reason upon ninety (90) days prior written notice. In addition, this Agreement will be automatically extended on the same terms and conditions for successive one-year periods following the original Employment Period unless either the Company or the Executive, at least ninety (90) days prior to the expiration of the original Employment Period or any extended term, shall give written notice of its or her intention not to renew this Agreement.

Section 5.02. **Unjustified Termination.** Except as otherwise provided in Section 12.09, if the Employment Period shall be terminated (i) at the end of the original or any extended Employment Period due to the Company giving written notice of non-extension pursuant to Section 5.01 above or (ii) prior to the expiration of the original Employment Period (or the Employment Period as extended pursuant to Section 5.01) by the Executive for Good Reason or by the Company not for Cause (such terminations under clauses (i) and (ii) of this Section 5.02 are collectively referred to as "**Unjustified Terminations**"), then:

(a) the Company shall continue to pay the Executive her Base Salary then in effect for a period of twelve (12) months following the Date of Termination;

(b) the Company shall make a lump-sum payment to the Executive of her Target Bonus then in effect;

(c) for a period of twelve (12) months following the Date of Termination, the unvested portion of any Time-Based RSUs held by the Executive shall continue to vest in equal monthly installments in an amount each month on the monthly anniversary of the grant date of the such Time-Based RSUs equal to the product of (i) the number of unvested Company restricted stock units under such Time-Based RSUs on the Date of Termination, *multiplied by* (ii) a fraction which has a numerator of one (1) and a denominator equal to the number of months remaining (measured from the Date of Termination) until the third anniversary of the grant date of such Time-Based RSUs; and

(d) for a period of twelve (12) months following the Date of Termination, the unvested portion of any Performance-Based RSUs held by the Executive shall continue to remain outstanding and be eligible to vest if the performance period with respect to such Performance-Based RSUs ends during such twelve (12) month period;

provided, however, that the Executive shall be entitled to such payments and benefits following Unjustified Terminations only if the Executive has not breached and does not breach in any material respect the provisions of Sections 6.01, 7.01, 8.01, 9.01 or 9.02 and the Executive has entered into a general release of claims reasonably satisfactory to the Company on or before the date that is fifty (50) days following the Date of Termination and does not revoke such release prior to the end of any revocation period. The period during which payments are made following an Unjustified Termination pursuant to Section 5.02(a), shall be referred to as "**Severance Period.**" Subject to Section 12.09 below, the amount payable under Section 5.02(a) shall be paid as follows: (A) the first two (2) months of the Base Salary shall be paid on the date that is two (2) months following the Date of Termination and (B) the remainder of the Base Salary payments shall be paid in accordance with the Company's regular pay practices, starting with the first pay date following the date that is two (2) months following the Date of Termination. Subject to Section 12.09 below, the amount payable under Section 5.02(b) shall be paid on the 60th day following the Date of Termination. In addition, promptly following an Unjustified Termination, the Executive shall also be reimbursed for all Reimbursable Expenses incurred by the Executive prior to such Unjustified Termination. Notwithstanding any provision hereof to the contrary, in order for the Executive to terminate the Employment Period for Good Reason, such termination of employment must occur no later than sixty (60) days after the date the Executive gives written notice in accordance with Section 5.05 below to the Company of the occurrence of the event or condition that constitutes Good Reason. Notwithstanding any provision of this Agreement to the contrary, for purposes of this Section 5.02 and the last sentence of Section 5.04, the Executive will be deemed to have terminated her employment on the date of her "separation from service" (within the meaning of Treasury Regulation Section 1.409A-1(h)) with the Company, the Employment Period will be deemed to have ended on the date of her "separation from service" with the Company, and the Date of Termination will be deemed to be the date of her "separation from service" with the Company. Without limiting the foregoing and Section 5.04, the Executive shall be entitled to the payments and benefits set forth in Section 4.04 which have accrued as of the Date of the Termination.

Section 5.03. **Justified Termination.** If the Employment Period shall be terminated (a) prior to the expiration of the original Employment Period (or the Employment Period as extended

pursuant to Section 5.01): (i) by the Company for Cause, (ii) as a result of the Executive's resignation or leaving of her employment, other than for Good Reason, or (iii) as a result of the death or Permanent Disability of the Executive, or (b) at the end of the Employment Period as a result of the Executive's provision of written notice not to extend the Employment Period under Section 5.01 (such terminations under clauses (a) and (b) of this Section 5.03 are collectively referred to as "**Justified Terminations**"), the Executive shall be entitled to receive solely (except as provided in Section 5.04 below) her Base Salary earned through the date of termination of employment, reimbursement of all Reimbursable Expenses incurred by the Executive prior to such Justified Termination and, if the Justified Termination is pursuant to clause (a)(iii) above, a prorated portion of the Executive's Target Bonus then in effect based on the number of days elapsed through the Date of Termination in the calendar year in which the Date of Termination occurs. Without limiting the foregoing and Section 5.04, the Executive shall be entitled to the payments and benefits set forth in Section 4.04 which have accrued as of the Date of the Termination. Notwithstanding the foregoing, if the Executive reaches Retirement Age, the unvested portion of each Annual RSU Award shall thereupon vest and be settled upon the regularly scheduled vesting dates.

Section 5.04. **Benefits.** Except as otherwise required by mandatory provisions of law, or as set forth in Section 9.01 following delivery of the Noncompetition Notice, all of the Executive's rights to fringe and other benefits under this Agreement or otherwise, if any, accruing after the termination of the Employment Period as a result of a Justified Termination will cease upon such Justified Termination. If the Employment Period is terminated as a result of an Unjustified Termination, then (a) during the Severance Period the Executive shall continue to receive her major medical insurance coverage under the Company's plans in effect on the Date of Termination and (b) the Company shall continue to provide the housing allowance set forth in Section 4.04(e) for the lesser of the Severance Period and the period during which the Executive remains a resident of Bermuda.

Section 5.05. **Notice of Termination and Opportunity to Cure.** Any termination by the Company for Permanent Disability or Cause or without Cause or by the Executive for Good Reason shall be communicated by written Notice of Termination to the other party hereto. For purposes of this Agreement, a "**Notice of Termination**" shall mean a notice which shall indicate the date the termination is to take effect (consistent with the terms of this Agreement), the specific termination provision in this Agreement relied upon and, for a termination for Permanent Disability or for Cause or for a resignation for Good Reason, shall set forth in reasonable detail the facts and circumstances claimed to provide a basis for termination of employment under the provision indicated. It shall be a condition precedent to the Executive's right to terminate employment for Good Reason that (i) the Executive shall first have given the Company written notice that an event or condition constituting Good Reason has occurred within ninety (90) days after such occurrence, and any failure to give such written notice within such period will result in a waiver by the Executive of her right to terminate for Good Reason as a result of such event or condition, and (ii) a period of thirty (30) days from and after the giving of such written notice shall have elapsed without the Company having effectively cured or remedied such occurrence during such 30-day period, unless such occurrence cannot be cured or remedied within thirty (30) days, in which case the period for remedy or cure shall be extended for a reasonable time (not to exceed an additional fifteen (15) days); **provided that**, the Company has made and continues to make a diligent effort to effect such remedy or cure.

Section 5.06. **Date of Termination.** "Date of Termination" shall mean (a) if the Employment Period is terminated as a result of a Permanent Disability, five (5) days after a Notice of Termination is given, (b) if the Employment Period is terminated by the Executive for Good Reason, the date specified in the Notice of Termination consistent with the terms hereof, (c) if the Employment Period terminates due to expiration of the term of this Agreement, the date the term expires, and (d) if the Employment Period is terminated for any other reason (including for Cause), the date designated by the Company in the Notice of Termination, which date shall be a date on or following the date of such Notice of Termination.

Section 5.07. **Change in Control.** In the event the Executive's employment is terminated by the Company without Cause or by the Executive for Good Reason (in accordance with requirements of Section 5.02 above) at any time following a Change in Control, then:

(a) the Company shall continue to pay the Executive her Base Salary then in effect for a period of twenty-four (24) months following the Date of Termination;

(b) the Company shall make a lump-sum payment to the Executive equal to two (2) times her Target Bonus then in effect;

(c) for a period of twenty-four (24) months following the Date of Termination the Executive shall continue to receive her major medical insurance coverage under the Company's plans in effect on the Date of Termination and the Company shall continue to provide the housing allowance set forth in Section 4.04(e) for the lesser of twenty-four (24) months following the Date of Termination and the period during which the Executive remains a resident of Bermuda;

(d) the unvested portion of any Time-Based RSUs held by the Executive shall thereupon vest; and

(e) the unvested portion of any Performance-Based RSUs held by the Executive shall thereupon vest as if performance goals with respect such Performance-Based RSUs had been achieved at target level;

provided, however, that the Executive shall be entitled to such payments and benefits following such terminations only if the Executive has not breached and does not breach in any material respect the provisions of Sections 6.01, 7.01, 8.01, 9.01 or 9.02 and the Executive has entered into a general release of claims reasonably satisfactory to the Company on or before the date that is fifty (50) days following the Date of Termination and does not revoke such release prior to the end of any revocation period. Subject to Section 12.09 below, the amount payable under Section 5.07(a) shall be paid as follows: (A) the first two (2) months of the Base Salary shall be paid on the date that is two (2) months following the Date of Termination and (B) the remainder of the Base Salary payments shall be paid in accordance with the Company's regular pay practices, starting with the first pay date following the date that is two (2) months following the Date of Termination. Subject to Section 12.09 below, the amount payable under Section 5.07(b) shall be paid on the 60th day following the Date of Termination. In addition, promptly following a termination under this Section 5.07, the Executive shall also be reimbursed for all Reimbursable Expenses incurred by the Executive prior to such termination. Notwithstanding any provision of this Agreement to the contrary, for purposes of this Section 5.07 and the last sentence of Section 5.04, the Executive will be deemed to have

terminated her employment on the date of her "separation from service" (within the meaning of Treasury Regulation Section 1.409A-1(h)) with the Company, the Employment Period will be deemed to have ended on the date of her "separation from service" with the Company, and the Date of Termination will be deemed to be the date of her "separation from service" with the Company. Without limiting the foregoing and Section 5.04, upon a termination under this Section 5.07, the Executive shall be entitled to the payments and benefits set forth in Section 4.04 which have accrued as of the Date of the Termination.

(f) If this Section 5.07 is applicable, Section 5.02 shall not apply.

ARTICLE 6 CONFIDENTIAL INFORMATION

Section 6.01. **Nondisclosure and Non-use of Confidential Information.** The Executive will not disclose or use at any time during or after the Employment Period any Confidential Information of which the Executive is or becomes aware, whether or not such Confidential Information is developed by her, except to the extent that such disclosure or use is directly related to and required by the Executive's performance of duties assigned to the Executive pursuant to this Agreement. Under all circumstances and at all times, the Executive will take all appropriate steps to safeguard Confidential Information in her possession and to protect it against disclosure, misuse, espionage, loss and theft.

ARTICLE 7 INTELLECTUAL PROPERTY

Section 7.01. **Ownership of Intellectual Property.** In the event that the Executive as part of her activities on behalf of the Company generates, authors or contributes to any invention, design, new development, device, product, method of process (whether or not patentable or reduced to practice or comprising Confidential Information), any copyrightable work (whether or not comprising Confidential Information) or any other form of Confidential Information relating directly or indirectly to the business of the Company as now or hereinafter conducted (collectively, "**Intellectual Property**"), the Executive acknowledges that such Intellectual Property is the sole and exclusive property of the Company and hereby assigns all right title and interest in and to such Intellectual Property to the Company. Any copyrightable work prepared in whole or in part by the Executive during the Employment Period will be deemed "a work made for hire" under Section 201(b) of the United States Copyright Act of 1976, as amended, and the Company will own all of the rights comprised in the copyright therein. The Executive will promptly and fully disclose all Intellectual Property and will cooperate with the Company to protect the Company's interests in and rights to such Intellectual Property (including providing reasonable assistance in securing patent protection and copyright registrations and executing all documents as reasonably requested by the Company, whether such requests occur prior to or after termination of Executive's employment hereunder).

ARTICLE 8 DELIVERY OF MATERIALS UPON TERMINATION OF EMPLOYMENT

Section 8.01. **Delivery of Materials upon Termination of Employment.** As requested by the Company, from time to time and upon the termination of the Executive's employment with (or services for) the Company for any reason, the Executive will promptly deliver to the Company all property of the Company in the Executive's possession or within her control, including, without limitation, all copies and embodiments, in whatever form or medium, of all Confidential Information or Intellectual Property (including written records, notes, photographs, manuals, notebooks, documentation, program listings, flow charts, magnetic media, disks, diskettes, tapes and all other materials containing any Confidential Information or Intellectual Property), irrespective of the location or form of such property and, if requested by the Company, will provide the Company with written confirmation that all such property has been delivered to the Company and/or deleted from computers, as applicable.

ARTICLE 9 NONCOMPETITION AND NONSOLICITATION

Section 9.01. **Noncompetition.**

(a) The Executive acknowledges that during her employment with the Company, she has, and will continue to, become familiar with trade secrets and other Confidential Information concerning the Company and its Affiliates and their respective predecessors, and that her services will be of special, unique and extraordinary value to the Company. In addition, the Executive hereby agrees that at any time (i) during the Employment Period, and (ii) (x) following a Justified Termination and delivery of the Noncompetition Notice by the Company to the Executive, for a period ending twelve (12) months after the termination of the Executive's employment and (y) following an Unjustified Termination, for a period ending twelve (12) months after the termination of the Executive's employment (the time described in clauses (i) and (ii), collectively, the "**Restricted Period**"), she will not directly or indirectly own, manage, control, participate in, consult with, render services for or in any manner engage in any business competing with the business of the Company or its Affiliates as such businesses exist or are in process as of the date of termination, within any geographical area in which the Company or its Affiliates engage or plan to engage in such businesses. It shall not be considered a violation of this Section 9.01 for the Executive to be a passive owner of not more than 2% of the outstanding stock of any class of a corporation which is publicly traded, so long as the Executive has no active participation in the business of such corporation. The terms of Section 9.01(a)(ii)(x) shall be of no force or effect unless the Company notifies the Executive in writing no later than ten (10) business days following a Justified Termination of its intention to enforce the provisions of Section 9.01(a)(ii)(x) (the "**Noncompetition Notice**").

(b) Subject to Section 12.09, in the event the Company provides the Executive with the Noncompetition Notice, (i) the Company shall be required to continue to pay the Executive the Base Salary for the Restricted Period, paid in accordance with the Company's regular pay practices, starting with the first pay date following delivery of the Noncompetition Notice, (ii) the Company shall be required to pay in a lump sum the Executive's Target Bonus then in effect on the first pay date following the delivery of the Noncompetition Notice, (iii) the Executive shall continue to receive major medical insurance coverage benefits from the Company's plans in effect at the time of such termination of employment for the Restricted Period, and (iv) the Company shall continue to provide the housing allowance set forth in Section 4.04(e) for the lesser of the Restricted Period and the period during which the Executive remains a resident of Bermuda.

Section 9.02. **Nonsolicitation.** The Executive acknowledges that during her employment with the Company, she has, and will continue to, become familiar with trade secrets and other Confidential Information concerning the Company, its Affiliates and their respective predecessors, and that her services are and will be of special, unique and extraordinary value to the Company. The Executive hereby agrees that during the Restricted Period, (a) the Executive will not, directly or indirectly, induce or attempt to induce any employee of the Company or its Affiliates to leave the employ of the Company or its Affiliates, or in any way interfere with the relationship between the Company or its Affiliates and any employee thereof or otherwise employ or receive the services of any individual who was an employee of the Company or its Affiliates at the Date of Termination or within the six-month period prior thereto, and (b) the Executive will not induce or attempt to induce any customer, supplier, client, insured, reinsured, reinsurer, broker, licensee or other business relation of the Company or its Affiliates to cease doing business with the Company or its Affiliates.

Section 9.03. **Enforcement.** If, at the enforcement of Sections 9.01 or 9.02, a court holds that the duration or scope stated therein are unreasonable under circumstances then existing, the parties agree that the maximum duration and scope reasonable under such circumstances will be substituted for the stated duration or scope and that the court will be permitted to revise the restrictions contained in this Article 9 to cover the maximum duration and scope permitted by law.

ARTICLE 10 EQUITABLE RELIEF

Section 10.01. **Equitable Relief.** The Executive acknowledges that (a) the covenants contained herein are reasonable, (b) the Executive's services are unique, and (c) a breach or threatened breach by her of any of her covenants and agreements with the Company contained in Sections 6.01, 7.01, 8.01, 9.01 or 9.02 could cause irreparable harm to the Company for which it might have no adequate remedy at law. Accordingly, and in addition to any remedies which the Company may have at law, in the event of an actual or threatened breach by the Executive of her covenants and agreements contained in Sections 6.01, 7.01, 8.01, 9.01 or 9.02, the Company shall have the absolute right to apply to any court of competent jurisdiction for such injunctive or other equitable relief as such court may deem necessary or appropriate in the circumstances.

ARTICLE 11 EXECUTIVE REPRESENTATIONS

Section 11.01. **Executive Representations.** The Executive hereby represents and warrants to the Company that (a) the execution, delivery and performance of this Agreement by the Executive does not and will not conflict with, breach, violate or cause a default under any contract, agreement, instrument, order, judgment or decree to which the Executive is a party or by which she is bound, (b) the Executive is not a party to or bound by any employment agreement, noncompetition agreement or confidentiality agreement with any other Person that affects her right or ability to perform the duties contemplated by this Agreement, and (c) upon the execution and delivery of this Agreement by the Company, this Agreement will be the valid and binding obligation of the Executive, enforceable in accordance with its terms.

Section 11.02. **Company Representations.** The Company hereby represents and warrants to the Executive that (a) all acts required to be taken to authorize, deliver and perform this Agreement

and the obligations of the Company provided for hereunder have been duly taken; and (b) upon the execution and delivery of this Agreement by the Company, this Agreement will be a valid and binding obligation of the Company, enforceable in accordance with its terms.

ARTICLE 12 MISCELLANEOUS

Section 12.01. **Remedies.** The Parties will have all rights and remedies set forth in this Agreement, all rights and remedies which the Parties have been granted at any time under any other agreement or contract and all of the rights which the Parties have under any law. The Parties will be entitled to enforce such rights specifically, without posting a bond or other security, to recover damages by reason of any breach of any provision of this Agreement and to exercise all other rights granted by law. There are currently no disciplinary or grievance procedures in place, there is no collective agreement in place, and there is no probationary period.

Section 12.02. **Consent to Amendments.** The provisions of this Agreement may be amended or waived only by a written agreement executed and delivered by the Company and the Executive. No other course of dealing between the parties to this Agreement or any delay in exercising any rights hereunder will operate as a waiver of any rights of any such parties.

Section 12.03. **Successors and Assigns.** All covenants and agreements contained in this Agreement by or on behalf of any of the parties hereto will bind and inure to the benefit of the respective successors and assigns of the parties hereto whether so expressed or not, **provided that** the Executive may not assign her rights or delegate her obligations under this Agreement without the written consent of the Company. The Company, or any entity which controls the Company, shall require any successor (whether direct or indirect, by purchase, merger, consolidation or otherwise) to all or substantially all of the business or assets of the Company by written agreement expressly to assume and agree to perform this Agreement in the same manner and to the same extent as the Company would be required to perform if no such succession had occurred. As used in this Agreement, "Company" shall mean the Company as defined above and any successor to all or substantially all of its business or assets which becomes bound by all of the terms and conditions of this Agreement.

Section 12.04. **Severability.** Whenever possible, each provision of this Agreement will be interpreted in such manner as to be effective and valid under applicable law, but if any provision of this Agreement is held to be prohibited by or invalid under applicable law, such provision will be ineffective only to the extent of such prohibition or invalidity, without invalidating the remainder of this Agreement.

Section 12.05. **Counterparts.** This Agreement may be executed simultaneously in two counterparts, any one of which need not contain the signatures of more than one party, but all of which counterparts taken together will constitute one and the same agreement.

Section 12.06. **Descriptive Headings.** The descriptive headings of this Agreement are inserted for convenience only and do not constitute a part of this Agreement.

Section 12.07. **Notices.** All notices, demands or other communications to be given or delivered under or by reason of the provisions of this Agreement will be in writing and shall be delivered personally by hand, by electronic transmission (with a copy following by hand or by overnight courier), by registered or certified mail, postage prepaid, return receipt requested, or by overnight courier service (charges prepaid). Communications delivered personally by hand shall be deemed received on the date when delivered personally to the recipient; communications sent by electronic means shall be deemed received one (1) business day after the sending thereof; communications sent by registered or certified mail shall be deemed received four (4) business days after the sending thereof; and communications delivered by overnight courier shall be deemed received one (1) business day after the date when sent to the recipient. Such notices, demands and other communications will be sent to the Executive and to the Company at the addresses set forth below.

If to the Executive:	To the last address delivered to the Company by the Executive in the manner set forth herein.
If to the Company:	Watford Holdings Ltd. Hamilton HM 12, Bermuda Attention: Secretary Tel: Fax: Email:

or to such other address or to the attention of such other person as the recipient party has specified by prior written notice to the sending party.

Section 12.08. **Withholding.** The Company may withhold from any amounts payable under this Agreement such federal, state, local or foreign taxes as shall be required to be withheld pursuant to any applicable law or regulation.

Section 12.09. **409A and 457A.** It is intended that this Agreement will comply with Sections 409A and 457A of the Internal Revenue Code of 1986, as amended (the "**Code**") (and any regulations and guidelines issued thereunder), to the extent the Agreement is subject thereto, and the Agreement shall be interpreted on a basis consistent with such intent. If an amendment of the Agreement is necessary in order for it to comply with Section 409A or Section 457A, the parties hereto will negotiate in good faith to amend the Agreement in a manner that preserves the original intent of the parties to the extent reasonably possible. No action or failure to act, pursuant to this Section 12.09 shall subject the Company to any claim, liability, or expense, and the Company shall not have any obligation to indemnify or otherwise protect the Executive from the obligation to pay any taxes, interest or penalties pursuant to Section 409A or Section 457A of the Code.

Notwithstanding any provision to the contrary in this Agreement, if the Executive is deemed on the date of her "separation from service" (within the meaning of Treasury Regulation Section 1.409A-1(h)) to be a "specified employee" within the meaning of that term under Section 409A(a)(2)(B) of the Code, then with regard to any payment that is required to be delayed pursuant to Section 409A(a)(2)(B) of the Code (after taking into account the applicable provisions of Treasury Regulation Section 1.409A-1(b)(9)(iii)), the portion, if any, of such payment so required to be

delayed shall not be made prior to the earlier of (i) the expiration of the six (6)-month period measured from the date of her "separation from service" or (ii) the date of her death (the "**Delay Period**"). Upon the expiration of the Delay Period, all payments and benefits delayed pursuant to this Section (whether they would have otherwise been payable in a single sum or in installments in the absence of such delay) shall be paid or reimbursed to the Executive in a lump sum, and any remaining payments due under this Agreement shall be paid in accordance with the normal payment dates specified for them herein. Whenever payments under this Agreement are to be made in installments, each such installment shall be deemed to be a separate payment for purposes of Section 409A of the Code. Any payment to be made after receipt of an executed and irrevocable release within any specified period, in which such period begins in one taxable year of Executive and ends in a second taxable year of Executive, will be made in the second taxable year. In no case will compliance with this Section by the Company constitute a breach of the Company's obligations under this Agreement.

With respect to any reimbursement or in-kind benefit arrangements of the Company and its subsidiaries provided for herein that constitute deferred compensation for purposes of Section 409A, except as otherwise permitted by Section 409A, the following conditions shall be applicable: (i) the amount eligible for reimbursement, or in-kind benefits provided, under any such arrangement in one calendar year may not affect the amount eligible for reimbursement, or in-kind benefits to be provided, under such arrangement in any other calendar year (except that the health and dental plans may impose a limit on the amount that may be reimbursed or paid), (ii) any reimbursement must be made on or before the last day of the calendar year following the calendar year in which the expense was incurred, and (iii) the right to reimbursement or in-kind benefits is not subject to liquidation or exchange for another benefit.

Notwithstanding anything to the contrary in this Agreement, all payments or benefits that are due after December 31 of the calendar year following the calendar year in which such payment or benefit vests for purposes of Section 457A of the Code, shall be made or provided on such December 31.

Section 12.10. **Excess Parachute Payments.** (a) Notwithstanding any other provision of this Agreement, in the event that the amount of payments or other benefits payable to the Executive under this Agreement (including, without limitation, the acceleration of any payment or the accelerated vesting of any payment or other benefit), together with any payments, awards or benefits payable under any other plan, program, arrangement or agreement maintained by the Company or one of its Affiliates, would constitute an "excess parachute payment" (within the meaning of Section 280G of the Code), the payments under Section 5.02 of this Agreement shall be reduced (by the minimum possible amounts) until no amount payable to the Executive under this Agreement constitutes an "excess parachute payment" (within the meaning of Section 280G of the Code); **provided, however, that** no such reduction shall be made if the net after-tax payment (after taking into account federal, state, local or other income, employment and excise taxes) to which the Executive would otherwise be entitled without such reduction would be greater than the net after-tax payment (after taking into account federal, state, local or other income, employment and excise taxes) to the Executive resulting from the receipt of such payments with such reduction.

(b) All determinations required to be made under this Section 12.10, including whether a payment would result in an "excess parachute payment" and the assumptions to be utilized in arriving at such determinations, shall be made by an accounting firm designated by the Company

(the "**Accounting Firm**") which shall provide detailed supporting calculations both to the Company and the Executive as requested by the Company or the Executive. All fees and expenses of the Accounting Firm shall be borne solely by the Company and shall be paid by the Company. Absent manifest error, all determinations made by the Accounting Firm under this Section 12.10 shall be final and binding upon the Company and the Executive.

Section 12.11. **No Third Party Beneficiary.** This Agreement will not confer any rights or remedies upon any person other than the Company, the Executive and their respective heirs, executors, successors and assigns.

Section 12.12. **Entire Agreement.** This Agreement (including the documents referred to herein) constitutes the entire agreement among the parties and supersedes any prior understandings, agreements or representations by or among the parties, written or oral, that may have related in any way to the subject matter hereof. This Agreement shall serve as a written statement of employment for purposes of Section 6 of the Bermuda Employment Act 2000.

Section 12.13. **Construction.** The language used in this Agreement will be deemed to be the language chosen by the parties to express their mutual intent, and no rule of strict construction will be applied against any party. Any reference to any federal, state, local or foreign statute or law will be deemed also to refer to all rules and regulations promulgated thereunder, unless the context requires otherwise. The use of the word "**including**" in this Agreement means including without limitation and is intended by the parties to be by way of example rather than limitation.

Section 12.14. **Survival.** Sections 3.04, 4.04(i), 5.02, 5.03, 5.04, 6.01, 7.01, 8.01 and Articles 9, 10, 11 and 12 will survive and continue in full force in accordance with their terms notwithstanding any termination of the Employment Period.

Section 12.15. **Governing Law.** ALL QUESTIONS CONCERNING THE CONSTRUCTION, VALIDITY AND INTERPRETATION OF THIS AGREEMENT WILL BE GOVERNED BY THE INTERNAL LAW OF NEW YORK, WITHOUT REGARD TO PRINCIPLES OF CONFLICT OF LAWS.

Section 12.16. **Jurisdiction.** The parties agree to the nonexclusive jurisdiction of the federal and state courts situated in New York County, New York, for the resolution of any dispute arising under this Agreement or under any share-based award agreements between the Company and the Executive.

Section 12.17. **No Activity Within the United States.** Except as otherwise indicated in guidelines adopted by the Company and supplementing the foregoing (including the guidelines entitled "Tax Operating Guidelines: Watford Re Ltd. and Watford Holdings (U.S.) Inc." previously adopted by the Company, the Executive, when acting on behalf of the Company,

(a) will not negotiate or discuss the terms of specific transactions from any location within the United States, or otherwise actively or regularly solicit the sale of insurance or reinsurance from within the United States (it being understood that (i) the Executive will, on behalf of the Company, be permitted to solicit and accept submissions from brokers or directly from insureds or insurance company clients located within the United States, so long as all underwriting

analysis and negotiation on behalf of the Company with respect to any such referred contract is undertaken from outside the United States and (ii) the Executive may, on behalf of the Company, engage in occasional visits and marketing contacts with clients, potential clients or reinsurance intermediaries in the United States, so long as only general business objectives of the Company are discussed);

(b) will only evaluate and accept proposals for insurance and reinsurance from the Company, negotiate or execute contracts on behalf of the Company, or deliver evidences of insurance or reinsurance from locations outside the United States;

(c) will only issue premium invoices from outside the United States, and will only accept premium payments at, or pay claims from, a location outside the United States;

(d) will not otherwise engage in business on behalf of the Company (including responding to emails or participating in phone calls where substantive issues are discussed) from locations within the United States; and

(e) prior to undertaking any action on behalf of the Company from a location other than Bermuda or the United States, will obtain advice of counsel to the effect that such action, either alone or in conjunction with other actions taken on behalf of the Company in such jurisdiction, will not cause the Company to be or become subject to taxation in such jurisdiction.

[Signature page follows]

IN WITNESS WHEREOF, the parties hereto have executed this Agreement as of the date and year first above written.

WATFORD HOLDINGS LTD.

By: /s/ John Rathgeber
Name: John Rathgeber
Title: Chief Executive Officer

By: /s/ Liz Cunningham
Name: Liz Cunningham

Certification
of Chief Executive Officer
Pursuant to Section 302 of the
Sarbanes-Oxley Act of 2002

I, Jonathan D. Levy, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Watford Holdings Ltd.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in the report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the financial statements for external purposes in accordance with generally accepted accounting principles;
 - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and to the audit committee of registrant's board of directors (or persons performing the equivalent functions):
 - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely

Certification
of Chief Financial Officer
Pursuant to Section 302 of the
Sarbanes-Oxley Act of 2002

I, Robert L. Hawley, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Watford Holdings Ltd.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in the report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the financial statements for external purposes in accordance with generally accepted accounting principles;
 - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and to the audit committee of registrant's board of directors (or persons performing the equivalent functions):
 - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely

Certification Pursuant to Chapter 63, Title 18 United States Code §1350
As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

In connection with the Quarterly Report of Watford Holdings Ltd. (the "Company") on Form 10-Q for the period ending March 31, 2020 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), Robert L. Hawley, as Chief Financial Officer of the Company, certifies pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. the Report fully complies with the requirements of section 13(a) of the Securities Exchange Act of 1934; and
2. the information contained in such report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: May 11, 2020

By: /s/ Robert L. Hawley

Name: Robert L. Hawley

Title: Chief Financial Officer

A signed original of this written statement required by Section 906 or other document authenticating, acknowledging or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to Watford Holdings Ltd. and will be retained by Watford Holdings Ltd. and furnished to the Securities and Exchange Commission or its staff upon request.