

AUDITED FINANCIAL STATEMENTS

Top Layer Reinsurance Ltd.

December 31, 2020 and 2019





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Report of Independent Auditors

TO THE BOARD OF DIRECTORS OF
TOP LAYER REINSURANCE LTD.

We have audited the accompanying financial statements of Top Layer Reinsurance Ltd., which comprise the balance sheets as of December 31, 2020 and 2019, and the related statements of operations, changes in shareholders' equity, and cash flow for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in conformity with U.S. generally accepted accounting principles; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free of material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Top Layer Reinsurance Ltd. at December 31, 2020 and 2019, and the results of their operations and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Required Supplementary Information

Accounting principles generally accepted in the United States require that the incurred and paid claims development prior to the most recent year and the average annual percentage payout of incurred claims disclosed on pages 19 through 23 be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the Financial Accounting Standards Board who considers it to be an essential part of financial reporting for placing the financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the financial statements, and other knowledge we obtained during our audit of the financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Ernst & Young Ltd.

Hamilton, Bermuda
April 26, 2021

**TOP LAYER REINSURANCE LTD.
BALANCE SHEETS
AT DECEMBER 31, 2020 AND 2019
(in thousands of United States Dollars)**

	2020	2019
Assets		
Fixed maturity investments trading, at fair value - amortized cost \$43,425 at December 31, 2020 (2019 - \$49,648) (Notes 3 and 4)	\$ 43,952	\$ 50,235
Short term investments, at fair value (Note 4)	4,776	4,308
Total investments	48,728	54,543
Cash and cash equivalents	10,822	23,243
Premiums receivable	5,267	4,394
Prepaid reinsurance premiums (Note 5)	4,194	4,097
Accrued investment income	97	274
Deferred acquisition costs	1,119	1,035
Other assets (Notes 4 and 11)	326	128
Total assets	\$ 70,553	\$ 87,714
 Liabilities and Shareholders' Equity		
Liabilities		
Reserve for claims and claim expenses (Note 6)	\$ 4,970	\$ 6,026
Unearned premiums	10,110	9,316
Reinsurance balances payable	65	531
Accounts payable and accrued liabilities (Note 8)	1,060	971
Other liabilities (Notes 4 and 11)	431	142
Total liabilities	16,636	16,986
Shareholders' Equity		
Common shares: \$1.00 par value – 120,000 shares authorized, issued and outstanding at December 31, 2020 and 2019 (Note 7)	120	120
Additional paid-in capital (Note 7)	34,594	52,794
Retained earnings	19,203	17,814
Total shareholders' equity	53,917	70,728
Total liabilities and shareholders' equity	\$ 70,553	\$ 87,714

On behalf of the Board:



Director

See accompanying notes to the financial statements

TOP LAYER REINSURANCE LTD.
STATEMENTS OF OPERATIONS
FOR THE YEARS ENDED DECEMBER 31, 2020 AND 2019
(in thousands of United States Dollars)

	<u>2020</u>	<u>2019</u>
Revenues		
Gross premiums written (Note 5)	\$ 37,884	\$ 35,338
Net premiums written (Note 5)	\$ 22,357	\$ 19,918
(Increase) decrease in net unearned premiums (Note 5)	(697)	41
Net premiums earned (Note 5)	21,660	19,959
Net investment income (Note 3)	671	1,393
Net foreign exchange gains (Notes 6 and 11)	752	119
Net realized and unrealized gains on investments (Note 3)	1,365	993
Total revenues	<u>24,448</u>	<u>22,464</u>
Expenses		
Acquisition expenses	2,435	2,244
Operational expenses (Note 8)	2,824	2,617
Total expenses	<u>5,259</u>	<u>4,861</u>
Net income	<u>\$ 19,189</u>	<u>\$ 17,603</u>

See accompanying notes to the financial statements

TOP LAYER REINSURANCE LTD.
STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
FOR THE YEARS ENDED DECEMBER 31, 2020 AND 2019
(in thousands of United States Dollars)

	2020	2019
Common shares	\$ 120	\$ 120
Additional paid-in capital		
Balance – January 1	52,794	75,294
Return of capital (Note 7)	(18,200)	(22,500)
Balance – December 31	34,594	52,794
Retained earnings		
Balance – January 1	17,814	17,711
Net income	19,189	17,603
Dividends declared (Note 7)	(17,800)	(17,500)
Balance – December 31	19,203	17,814
Total shareholders' equity	\$ 53,917	\$ 70,728

See accompanying notes to the financial statements

TOP LAYER REINSURANCE LTD.
STATEMENTS OF CASH FLOW
FOR THE YEARS ENDED DECEMBER 31, 2020 AND 2019
(in thousands of United States Dollars)

	2020	2019
<i>Cash flows provided by operating activities</i>		
Net income	\$ 19,189	\$ 17,603
<i>Adjustments to reconcile net income to net cash provided by operating activities</i>		
Amortization and accretion	43	(52)
Net realized and unrealized (gains) on investments	(1,365)	(993)
Change in:		
Premiums receivable	(873)	(774)
Prepaid reinsurance premiums	(97)	264
Deferred acquisition costs	(84)	25
Reserve for claims and claim expenses	(1,056)	(1,366)
Unearned premiums	794	(305)
Reinsurance balances payable	(466)	303
Other, net	357	526
<i>Net cash provided by operating activities</i>	16,442	15,231
<i>Cash flows provided by investing activities</i>		
Proceeds from sales and maturities of fixed maturity investments trading	70,246	271,386
Purchases of fixed maturity investments trading	(62,651)	(234,475)
Net purchases of short term investments	(458)	(3,326)
<i>Net cash provided by investing activities</i>	7,137	33,585
<i>Cash flows used in financing activities</i>		
Dividends paid	(17,800)	(17,500)
Return of capital	(18,200)	(22,500)
<i>Net cash used in financing activities</i>	(36,000)	(40,000)
<i>Net (decrease) increase in cash and cash equivalents</i>	(12,421)	8,816
<i>Cash and cash equivalents, beginning of period</i>	23,243	14,427
<i>Cash and cash equivalents, end of period</i>	\$ 10,822	\$ 23,243

See accompanying notes to the financial statements

TOP LAYER REINSURANCE LTD.
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2020 AND 2019
(amounts in tables expressed in thousands of United States Dollars)

NOTE 1. ORGANIZATION

Top Layer Reinsurance Ltd. (the “Company”) was incorporated under the laws of Bermuda on January 6, 1999 to provide high layer, non-U.S. property reinsurance written on an excess of loss basis. The Company is a joint venture between Renaissance Reinsurance Ltd. (“Renaissance Reinsurance”), a Bermuda company and wholly owned subsidiary of RenaissanceRe Holdings Ltd. (“RenaissanceRe”), and State Farm Mutual Automobile Insurance Company (“State Farm”), a United States company.

NOTE 2. SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

These financial statements have been prepared on the basis of accounting principles generally accepted in the United States (“GAAP”).

Use of Estimates in Financial Statements

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported and disclosed 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 materially from those estimates. The major estimates reflected in the Company’s financial statements include, but are not limited to, the reserve for claims and claim expenses, reinsurance recoverables and fair value, including the fair value of investments, financial instruments and derivatives.

Premiums and Related Expenses

Premiums are recognized as income, net of any applicable retrocessional coverage purchased, over the terms of the related contracts and policies. Premiums written are based on contract and policy terms and include estimates based on information received from both insureds and ceding companies. Subsequent differences arising on such estimates are recorded in the period in which they are determined. Unearned premiums represent the portion of premiums written that relate to the unexpired terms of contracts and policies in force. Amounts are computed by pro rata methods based on statistical data or reports received from ceding companies. Reinstatement premiums are estimated after the occurrence of a significant loss and are recorded in accordance with the contract terms based upon paid losses and case reserves. Reinstatement premiums are earned when written.

Acquisition costs are incurred when a contract or policy is issued and only the costs directly related to the successful acquisition of new and renewal contracts or policies are deferred and amortized over the same period in which the related premiums are earned. Acquisition costs are shown net of commissions earned on ceded reinsurance, and consist principally of commissions and brokerage expenses incurred at the time a contract or policy is issued. Deferred policy acquisition costs are limited to their estimated realizable value based on the related unearned premiums. Anticipated claims and claim expenses, based on historical and current experience, and anticipated investment income related to those premiums are considered in determining the recoverability of deferred acquisition costs.

Claims and Claim Expenses

The reserve for claims and claim expenses includes estimates for unpaid claims and claim expenses on reported losses as well as an estimate of losses incurred but not reported (“IBNR”). The reserve is based on individual claims, case reserves and other reserve estimates reported by insureds and ceding companies as well as management estimates of ultimate losses. Inherent in the estimates of ultimate losses are expected trends in claim severity and frequency and other factors which could vary significantly as claims are settled.

TOP LAYER REINSURANCE LTD.
NOTES TO THE FINANCIAL STATEMENTS
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(amounts in tables expressed in thousands of United States Dollars)

NOTE 2. SIGNIFICANT ACCOUNTING POLICIES, cont'd.

Ultimate losses may vary materially from the amounts provided in the financial statements. These estimates are reviewed regularly and, as experience develops and new information becomes known, the reserves are adjusted as necessary. Such adjustments, if any, are reflected in the statements of operations in the period in which they become known and are accounted for as changes in estimates.

Reinsurance

Amounts recoverable from reinsurers are estimated in a manner consistent with the claim liability associated with the reinsured policies. If the Company determines that adjustments to earlier estimates are appropriate, such adjustments are recorded in the period in which they are determined. Amounts recoverable from reinsurers are recorded net of a provision for current expected credit losses to reflect expected credit losses.

Investments, Cash and Cash Equivalents

Fixed Maturity Investments

Investments in fixed maturities are classified as trading and are reported at fair value. Investment transactions are recorded on the trade date with balances pending settlement reflected in the balance sheet as a receivable for investments sold or a payable for investments purchased. Net investment income includes interest together with amortization of market premiums and discounts and is net of investment management and custody fees. The amortization of premium and accretion of discount for fixed maturity securities is computed using the effective yield method. For mortgage-backed securities and other holdings for which there is prepayment risk, prepayment assumptions are evaluated quarterly and revised as necessary. Any adjustments required due to the change in effective yield and maturities are recognized on a prospective basis through yield adjustments. Fair values of fixed maturity investments are based on quoted market prices, or when such prices are not available, by reference to broker or underwriter bid indications and/or internal pricing valuation techniques. The net unrealized appreciation or depreciation on fixed maturity investments trading is included in net realized and unrealized gains (losses) on investments in the statements of operations. Realized gains or losses on the sale of fixed maturity investments are determined on the basis of the first in first out cost method.

Short Term Investments

Short term investments, which are managed as part of the Company's investment portfolio and have a maturity of one year or less when purchased, are carried at fair value. The net unrealized appreciation or depreciation on these short term investments is included in net realized and unrealized gains (losses) on investments in the statements of operations.

Cash and Cash Equivalents

Cash equivalents include money market instruments with a maturity of ninety days or less when purchased.

TOP LAYER REINSURANCE LTD.
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2020 AND 2019
(amounts in tables expressed in thousands of United States Dollars)

NOTE 2. SIGNIFICANT ACCOUNTING POLICIES, cont'd.

Derivatives

The Company may enter into derivative instruments such as forward contracts primarily to manage its foreign currency exposure. The Company accounts for its derivatives in accordance with Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic *Derivatives and Hedging*, which requires all derivatives to be recorded at fair value on the Company's balance sheet as either assets or liabilities, depending on their rights or obligations, with changes in fair value reflected in current earnings. The Company does not currently apply hedge accounting. The fair value of the Company's derivatives is estimated by reference to quoted prices or broker quotes, where available, or in the absence of quoted prices or broker quotes, the use of industry or internal valuation models.

Fair Value

The Company accounts for certain of its assets and liabilities at fair value in accordance with FASB ASC Topic *Fair Value Measurements and Disclosures*. The Company recognizes the change in unrealized gains and losses arising from changes in fair value in its statements of operations.

Foreign Exchange

The Company's functional currency is the U.S. dollar. Revenues and expenses denominated in foreign currencies are revalued at the prevailing exchange rate at the transaction date. Monetary assets and liabilities denominated in foreign currencies are remeasured at exchange rates in effect at the balance sheet date, which may result in the recognition of exchange gains or losses which are included in the determination of net income.

Recently Adopted Accounting Pronouncements

Measurement of Credit Losses on Financial Instruments

In June 2016, the FASB issued ASU No. 2016-13, *Measurement of Credit Losses on Financial Instruments* ("ASU 2016-13"). ASU 2016-13 modifies the recognition of credit losses by replacing the incurred loss impairment methodology with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. ASU 2016-13 is applicable to financial assets such as loans, debt securities, trade receivables, off-balance sheet credit exposures, reinsurance receivables, and other financial assets that have the contractual right to receive cash. The measurement of expected credit losses is based on relevant information about past events, including historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the reported amount. The Company's invested assets are measured at fair value through net income, and therefore those invested assets were not impacted by the adoption of ASU 2016-13. The Company has other financial assets, such as premiums receivable and reinsurance recoverable that were not materially impacted by the adoption of ASU 2016-13. ASU 2016-13 became effective for public business entities that are SEC filers for annual and interim periods beginning after December 15, 2019. For all other entities, ASU 2016-13 is effective for fiscal years beginning after December 15, 2020. Accordingly, the Company adopted ASU 2016-13 effective January 1, 2020. The adoption of ASU 2016-13 did not have a material impact on the Company's statements of operations and financial position, and as a result, there was no cumulative effect adjustment to opening retained earnings as of January 1, 2020.

TOP LAYER REINSURANCE LTD.
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NOTE 2. SIGNIFICANT ACCOUNTING POLICIES, cont'd.

Disclosure Framework - Changes to the Disclosure Requirements for Fair Value Measurement

In August 2018, the FASB issued ASU No. 2018-13, *Disclosure Framework - Changes to the Disclosure Requirements for Fair Value Measurement* ("ASU 2018-13"). The ASU 2018-13 modifies the disclosure requirements of fair value measurements as part of the disclosure framework project with the objective to improve the effectiveness of disclosures in the notes to the financial statements. ASU 2018-13 allows for removal of the amount and reasons for transfer between Level 1 and Level 2 of the fair value hierarchy; the policy for transfers between levels; and the valuation processes for Level 3 fair value measurements. ASU 2018-13 became effective for all entities for fiscal years beginning after December 15, 2019 and interim periods within those fiscal years. Accordingly, the Company adopted ASU 2018-13 effective January 1, 2020. Since ASU 2018-13 is disclosure-related only, it did not have an impact on the Company's statements of operations and financial position.

NOTE 3. INVESTMENTS

Fixed Maturity Investments Trading

The following table summarizes the fair value of fixed maturity investments trading:

<u>At December 31,</u>	<u>2020</u>	<u>2019</u>
U.S. treasuries	\$ 22,321	\$ 27,168
Non-U.S. government	171	—
Non-U.S. government-backed corporate	1,035	1,087
Corporate	15,030	17,545
Agency mortgage-backed	2,860	2,922
Commercial mortgage-backed	109	695
Asset-backed	2,426	818
Total fixed maturity investments trading	<u>\$ 43,952</u>	<u>\$ 50,235</u>

Contractual maturities of fixed maturity investments trading are described in the following table. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

TOP LAYER REINSURANCE LTD.
NOTES TO THE FINANCIAL STATEMENTS
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NOTE 3. INVESTMENTS, cont'd.

At December 31, 2020	Amortized Cost	Fair Value
Due in less than one year	\$ 3,024	\$ 3,056
Due after one through five years	33,812	34,263
Due after five through ten years	1,215	1,238
Mortgage-backed	2,957	2,969
Asset-backed	2,417	2,426
Total	<u>\$ 43,425</u>	<u>\$ 43,952</u>

Net Investment Income

The components of net investment income are as follows:

Year ended December 31,	2020	2019
Fixed maturity investments	\$ 694	\$ 1,197
Short term investments	16	137
Cash and cash equivalents	25	141
	735	1,475
Investment expenses	(64)	(82)
Net investment income	<u>\$ 671</u>	<u>\$ 1,393</u>

Net Realized and Unrealized Gains on Investments

Net realized and unrealized gains (losses) on investments are as follows:

Year ended December 31,	2020	2019
Gross realized gains	\$ 1,464	\$ 399
Gross realized losses	(39)	(255)
Net realized gains on fixed maturity investments	1,425	144
Net unrealized (losses) gains on fixed maturity investments trading	(60)	849
Net realized and unrealized gains on investments	<u>\$ 1,365</u>	<u>\$ 993</u>

TOP LAYER REINSURANCE LTD.
NOTES TO THE FINANCIAL STATEMENTS
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(amounts in tables expressed in thousands of United States Dollars)

NOTE 4. FAIR VALUE MEASUREMENTS

The use of fair value to measure certain assets and liabilities with resulting unrealized gains or losses is pervasive within the Company's financial statements. Fair value is defined under accounting guidance currently applicable to the Company to be the price that would be received upon the sale of an asset or paid to transfer a liability in an orderly transaction between open market participants at the measurement date. The Company recognizes the change in unrealized gains and losses arising from changes in fair value in its statements of operations.

FASB ASC Topic *Fair Value Measurements and Disclosures* prescribes a fair value hierarchy that prioritizes the inputs to the respective valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to valuation techniques that use at least one significant input that is unobservable (Level 3). The three levels of the fair value hierarchy are described below:

- Fair values determined by Level 1 inputs utilize unadjusted quoted prices obtained from active markets for identical assets or liabilities for which the Company has access. The fair value is determined by multiplying the quoted price by the quantity held by the Company;
- Fair values determined by Level 2 inputs utilize inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 inputs include quoted prices for similar assets and liabilities in active markets, and inputs other than quoted prices that are observable for the asset or liability, such as interest rates and yield curves that are observable at commonly quoted intervals, broker quotes and certain pricing indices; and
- Level 3 inputs are based all or in part on significant unobservable inputs for the asset or liability, and include situations where there is little, if any, market activity for the asset or liability. In these cases, significant management assumptions can be used to establish management's best estimate of the assumptions used by other market participants in determining the fair value of the asset or liability.

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, the level in the fair value hierarchy within which the fair value measurement in its entirety falls has been determined based on the lowest level input that is significant to the fair value measurement of the asset or liability. The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and the Company considers factors specific to the asset or liability.

In order to determine if a market is active or inactive for a security, the Company considers a number of factors, including, but not limited to, the spread between what a seller is asking for a security and what a buyer is bidding for the same security, the volume of trading activity for the security in question, the price of the security compared to its par value (for fixed maturity investments), and other factors that may be indicative of market activity.

There have been no material changes in the Company's valuation techniques, nor have there been any transfers between Level 1 and Level 2, or transfers into or out of Level 3, respectively, during the period represented by these financial statements.

TOP LAYER REINSURANCE LTD.
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2020 AND 2019
(amounts in tables expressed in thousands of United States Dollars)

NOTE 4. FAIR VALUE MEASUREMENTS, cont'd.

Below is a summary of the assets and liabilities that are measured at fair value on a recurring basis and also represents the carrying amount on the Company's balance sheets:

<u>At December 31, 2020</u>	<u>Total</u>	<u>Quoted Prices in Active Markets for Identical Assets (Level 1)</u>	<u>Significant Other Observable Inputs (Level 2)</u>	<u>Significant Unobservable Inputs (Level 3)</u>
Fixed maturity investments				
U.S. treasuries	\$ 22,321	\$ 22,321	\$ —	\$ —
Non-U.S. government	171	—	171	—
Non-U.S. government-backed corporate	1,035	—	1,035	—
Corporate	15,030	—	15,030	—
Agency mortgage-backed	2,860	—	2,860	—
Commercial mortgage-backed	109	—	109	—
Asset-backed	2,426	—	2,426	—
Total fixed maturity investments	43,952	22,321	21,631	—
Short term investments	4,776	—	4,776	—
Derivative assets (1)	326	—	326	—
Derivative liabilities (1)	(431)	—	(431)	—
	<u>\$ 48,623</u>	<u>\$ 22,321</u>	<u>\$ 26,302</u>	<u>\$ —</u>

(1) Refer to "Note 11. Derivative Instruments" for additional information related to the fair value by type of contract, of derivatives entered into by the Company, included in other assets and liabilities on its balance sheets.

TOP LAYER REINSURANCE LTD.
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2020 AND 2019
(amounts in tables expressed in thousands of United States Dollars)

NOTE 4. FAIR VALUE MEASUREMENTS, cont'd.

<u>At December 31, 2019</u>	<u>Total</u>	<u>Quoted Prices in Active Markets for Identical Assets (Level 1)</u>	<u>Significant Other Observable Inputs (Level 2)</u>	<u>Significant Unobservable Inputs (Level 3)</u>
Fixed maturity investments				
U.S. treasuries	\$ 27,168	\$ 27,168	\$ —	\$ —
Non-U.S. government-backed corporate	1,087	—	1,087	—
Corporate	17,545	—	17,545	—
Agency mortgage-backed	2,922	—	2,922	—
Commercial mortgage-backed	695	—	695	—
Asset-backed	818	—	818	—
Total fixed maturity investments	<u>50,235</u>	<u>27,168</u>	<u>23,067</u>	<u>—</u>
Short term investments	4,308	—	4,308	—
Derivative assets (1)	128	—	128	—
Derivative liabilities (1)	(142)	—	(142)	—
	<u>\$ 54,529</u>	<u>\$ 27,168</u>	<u>\$ 27,361</u>	<u>\$ —</u>

(1) Refer to "Note 11. Derivative Instruments" for additional information related to the fair value by type of contract, of derivatives entered into by the Company, included in other assets and liabilities on its balance sheets.

Level 1 and Level 2 Assets and Liabilities Measured at Fair Value

Fixed Maturity Investments

Fixed maturity investments included in Level 1 consist of the Company's investments in U.S. treasuries. Fixed maturity investments included in Level 2 are non-U.S. government, non-U.S. government-backed corporate, corporate, agency mortgage-backed, commercial mortgage-backed and asset-backed fixed maturity investments.

The Company's fixed maturity investments are primarily priced using pricing services, such as index providers and pricing vendors, as well as broker quotations. In general, the pricing vendors provide pricing for a high volume of liquid securities that are actively traded. For securities that do not trade on an exchange, the pricing services generally utilize market data and other observable inputs in matrix pricing models to determine month end prices. Observable inputs include benchmark yields, reported trades, broker-dealer quotes, issuer spreads, bids, offers, reference data and industry and economic events. Index pricing generally relies on market traders as the primary source for pricing; however, models are also utilized to provide prices for all index eligible securities. The models use a variety of observable inputs such as benchmark yields, transactional data, dealer runs, broker-dealer quotes and corporate actions. Prices are generally verified using third party data. Securities which are priced by an index provider are generally included in the index.

TOP LAYER REINSURANCE LTD.
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NOTE 4. FAIR VALUE MEASUREMENTS, cont'd.

In general, broker-dealers value securities through their trading desks based on observable inputs. The methodologies include mapping securities based on trade data, bids or offers, observed spreads, and performance on newly issued securities. Broker-dealers also determine valuations by observing secondary trading of similar securities. Prices obtained from broker quotations are considered non-binding, however they are based on observable inputs and by observing secondary trading of similar securities obtained from active, non-distressed markets.

The Company considers these broker quotations to be Level 2 inputs as they are corroborated with other market observable inputs. The techniques generally used to determine the fair value of the Company's fixed maturity investments are detailed below by asset class.

U.S. Treasuries

Level 1 - At December 31, 2020, the Company's U.S. treasuries fixed maturity investments were primarily priced by pricing services and had a weighted average yield to maturity of 0.2% and a weighted average credit quality of AA (2019 - 1.6% and AA, respectively). When pricing these securities, the vendor services utilize daily data from many real time market sources, including active broker dealers. Certain data sources are regularly reviewed for accuracy to attempt to ensure the most reliable price source is used for each issue and maturity date.

Non-U.S. Government

Level 2 - At December 31, 2020, the Company's non-U.S. government fixed maturity investments had a weighted average yield to maturity of 0.2% and a weighted average credit quality of AAA. At December 31, 2019, the Company did not hold any non-U.S. government fixed maturity investments. The issuers of securities in this sector are non-U.S. governments and their respective agencies as well as supranational organizations. Securities held in these sectors are primarily priced by pricing services that employ proprietary discounted cash flow models to value the securities. Key quantitative inputs for these models are daily observed benchmark curves for treasury, swap and high issuance credits. The pricing services then apply a credit spread for each security which is developed by in-depth and real time market analysis. For securities in which trade volume is low, the pricing services utilize data from more frequently traded securities with similar attributes. These models may also be supplemented by daily market and credit research for international markets.

Non-U.S. Government-backed Corporate

Level 2 - At December 31, 2020, the Company's non-U.S. government-backed corporate fixed maturity investments had a weighted average yield to maturity of 0.4% and a weighted average credit quality of AA (2019 - 1.9% and AA, respectively). Non-U.S. government-backed fixed maturity investments are primarily priced by pricing services that employ proprietary discounted cash flow models to value the securities. Key quantitative inputs for these models are daily observed benchmark curves for treasury, swap and high issuance credits. The pricing services then apply a credit spread to the respective curve for each security which is developed by in-depth and real time market analysis. For securities in which trade volume is low, the pricing services utilize data from more frequently traded securities with similar attributes. These models may also be supplemented by daily market and credit research for international markets.

TOP LAYER REINSURANCE LTD.
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(amounts in tables expressed in thousands of United States Dollars)

NOTE 4. FAIR VALUE MEASUREMENTS, cont'd.

Corporate

Level 2 - At December 31, 2020, the Company's corporate fixed maturity investments principally consist of U.S. and international corporations and had a weighted average yield to maturity of 0.5% and a weighted average credit quality of AA (2019 - 1.9% and AA, respectively). The Company's corporate fixed maturity investments are primarily priced by pricing services. When evaluating these securities, the pricing services gather information from market sources regarding the issuer of the security and obtain credit data, as well as other observations from markets and sector news. Evaluations are updated by obtaining broker dealer quotes and other market information including actual trade volumes, when available. The pricing services also consider the specific terms and conditions of the securities, including any specific features which may influence risk. In certain instances, securities are individually evaluated using a spread which is added to the U.S. treasury curve or a security specific swap curve as appropriate.

Agency Mortgage-backed

Level 2 - At December 31, 2020, the Company's agency mortgage-backed fixed maturity investments included agency residential mortgage-backed securities with a weighted average yield to maturity of 0.9%, a weighted average credit quality of AA and a weighted average life of 6.0 years (2019 - 2.1%, AA and 5.6 years, respectively). The Company's agency mortgage-backed fixed maturity investments are primarily priced by pricing services using a mortgage pool specific model which utilizes daily inputs from the active to-be-announced market which is very liquid, as well as the U.S. treasury market. The model also utilizes additional information, such as the weighted average maturity, weighted average coupon and other available pool level data which is provided by the sponsoring agency. Valuations are also corroborated with daily active market quotes.

Commercial Mortgage-backed

Level 2 - At December 31, 2020, the Company's commercial mortgage-backed fixed maturity investments had a weighted average yield to maturity of 1.0%, a weighted average credit quality of AAA and a weighted average life of 0.4 years (2019 - 2.4%, AAA and 1.3 years, respectively). Securities held in these sectors are primarily priced by pricing services. The pricing services apply dealer quotes and other available trade information such as bids and offers, prepayment speeds which may be adjusted for the underlying collateral or current price data, the U.S. treasury curve and swap curve as well as cash settlement. The pricing services discount the expected cash flows for each security held in this sector using a spread adjusted benchmark yield based on the characteristics of the security.

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NOTE 4. FAIR VALUE MEASUREMENTS, cont'd.

Asset-backed

Level 2 - At December 31, 2020, the Company's asset-backed fixed maturity investments had a weighted average yield to maturity of 0.6%, a weighted average credit quality of AAA and a weighted average life of 0.7 years (2019 - 2.1%, AAA and 0.4 years, respectively). The underlying collateral for the Company's asset-backed fixed maturity investments primarily consists of bank loans, student loans, credit card receivables, auto loans and other receivables. Securities held in these sectors are primarily priced by pricing services. The pricing services apply dealer quotes and other available trade information such as bids and offers, prepayment speeds which may be adjusted for the underlying collateral or current price data, the U.S. treasury curve and swap curve as well as cash settlement. The pricing services determine the expected cash flows for each security held in this sector using historical prepayment and default projections for the underlying collateral and current market data. In addition, a spread is applied to the relevant benchmark and used to discount the cash flows noted above to determine the fair value of the securities held in this sector.

Short Term Investments

Level 2 - At December 31, 2020, the Company's short term investments had a weighted average yield to maturity of 0.1% and a weighted average credit quality of AAA (2019 - 1.8% and AAA, respectively). The fair value of the Company's portfolio of short term investments is generally determined using amortized cost which approximates fair value and, in certain cases, in a manner similar to the Company's fixed maturity investments noted above.

Other Assets and Liabilities

Derivatives

Level 2 - Other assets and liabilities include the fair value of certain foreign currency contracts which are determined using standard industry valuation models, with inputs to the valuation model based on observable market inputs, including foreign currency spot rates, interest rates including the risk free rate and the contract term.

Financial Instruments Disclosed, But Not Carried, at Fair Value

The Company uses various financial instruments in the normal course of its business. The Company's insurance contracts are excluded from the fair value of financial instruments accounting guidance, unless the Company elects the fair value option, and therefore, are not included in the amounts discussed herein. The carrying values of cash and cash equivalents, accrued investment income, receivables for investments sold, certain other assets, payables for investments purchased, certain other liabilities, and other financial instruments not included herein approximated their fair values.

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NOTE 5. REINSURANCE

The Company purchases reinsurance and other protection to manage its risk portfolio and to reduce its exposure to large losses. The Company has in place a catastrophe excess of loss retrocession contract (“stop-loss”) with State Farm, a related party, that provides for recovery of aggregate losses in excess of \$100.0 million in each contract year, as defined in the stop-loss, up to a limit of \$3.9 billion. The Company remains primarily liable to the extent that State Farm fails to meet its obligation under the stop-loss contract, however, in the event of insolvency of the Company, claimants can proceed directly against State Farm for payment of claims. Net earned premiums ceded to State Farm during the year ended December 31, 2020 were \$15.4 million (2019 - \$15.7 million).

The following table sets forth the effect of reinsurance and retrocessional activity on net premiums written and earned.

<u>Year ended December 31,</u>	<u>2020</u>	<u>2019</u>
<u>Premiums written</u>		
Assumed	\$ 37,884	\$ 35,338
Ceded	(15,527)	(15,420)
Net premiums written	<u>\$ 22,357</u>	<u>\$ 19,918</u>
 <u>Premiums earned</u>		
Assumed	\$ 37,090	\$ 35,643
Ceded	(15,430)	(15,684)
Net premiums earned	<u>\$ 21,660</u>	<u>\$ 19,959</u>

The Company adopted ASU 2016-13 effective January 1, 2020. In assessing an allowance for reinsurance assets, which is comprised of premiums receivable, the Company considers historical information, financial strength of reinsurers, collateralization amounts, and ratings to determine the appropriateness of the allowance. In assessing future default for reinsurance assets, the Company evaluates the provision for current expected credit losses under the probability of default and loss given default method. The Company utilizes its internal capital and risk models, which use counterparty ratings from major rating agencies, and assesses the current market conditions for the likelihood of default. The Company updates its internal capital and risk models for counterparty ratings and current market conditions on a periodic basis. Historically, the Company has not experienced material credit losses from reinsurance assets. The adoption of ASU 2016-13 did not have a material impact on the Company's statements of operations and financial position.

Premiums receivable reflect premiums written based on contract and policy terms and include estimates based on information received from both insureds and ceding companies and our own judgement. Consequently, premiums receivable include premiums reported by the ceding companies, supplemented by our estimates of premiums that are written but not reported. Due to the nature of reinsurance, ceding companies routinely report and remit premiums to us subsequent to the contract coverage period, although the time lag involved in the process of reporting and collecting premiums is typically shorter than the lag in reporting losses.

At December 31, 2020, the Company's premiums receivable balance was \$5.3 million (2019 - \$4.4 million). Of the Company's premiums receivable balance as of December 31, 2020, the majority are receivable from highly rated counterparties, and there was no provision for current expected credit losses.

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NOTE 6. RESERVE FOR CLAIMS AND CLAIM EXPENSES

General Description

The Company believes the most significant accounting judgment made by management is its estimate of claims and claim expense reserves. Claims and claim expense reserves represent estimates, including actuarial and statistical projections at a given point in time, of the ultimate settlement and administration costs for unpaid claims and claim expenses arising from the insurance and reinsurance contracts the Company sells. The Company establishes its claims and claim expense reserves by taking claims reported to the Company by insureds and ceding companies, but which have not yet been paid ("case reserves"), adding estimates for the anticipated cost of claims incurred but not yet reported to the Company, or incurred but not enough reported to the Company (collectively referred to as "IBNR") and, if deemed necessary, adding costs for additional case reserves which represent the Company's estimates for claims related to specific contracts previously reported to the Company which it believes may not be adequately estimated by the client as of that date, or adequately covered in the application of IBNR.

The following table summarizes the Company's claims and claim expense reserves, allocated between case reserves, additional case reserves and IBNR:

	<u>Case Reserves</u>	<u>Additional Case Reserves</u>	<u>IBNR</u>	<u>Total</u>
At December 31, 2020	\$ 4,970	\$ —	\$ —	\$ 4,970
At December 31, 2019	\$ 6,026	\$ —	\$ —	\$ 6,026

Activity in the liability for unpaid claims and claim expenses is summarized as follows:

Year ended December 31,	<u>2020</u>	<u>2019</u>
Reserves for claims and claim expenses as of beginning of period	\$ 6,026	\$ 7,392
Net incurred related to:		
Current year	—	—
Prior years	—	—
Total net incurred	—	—
Net paid related to:		
Current year	—	—
Prior years	1,449	1,454
Total net paid	1,449	1,454
Foreign exchange losses (1)	393	88
Reserves for claims and claim expenses as of end of period	4,970	6,026
Reinsurance recoverable as of December 31	—	—
Reserves for claims and claim expenses as of end of period	<u>\$ 4,970</u>	<u>\$ 6,026</u>

(1) Reflects the impact of the foreign exchange revaluation of the reserve for claims and claim expenses denominated in non-U.S. dollars as at the balance sheet date.

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NOTE 6. RESERVE FOR CLAIMS AND CLAIM EXPENSES, cont'd.

The Company's reserving methodology uses a loss reserving process that calculates a point estimate for its ultimate settlement and administration costs for claims and claim expenses. The Company does not calculate a range of estimates and does not discount any of its reserves for claims and claim expenses. The Company uses this point estimate, along with paid claims and case reserves, to record its best estimate of additional case reserves and IBNR in its financial statements. Under GAAP, the Company is not permitted to establish estimates for catastrophe claims and claim expense reserves until an event occurs that gives rise to a loss.

Reserving involves other uncertainties, such as the dependence on information from ceding companies, the time lag inherent in reporting information from the primary insurer to the Company or to the Company's ceding companies, and differing reserving practices among ceding companies. The information received from ceding companies is typically in the form of broker notifications of loss and/or discussions with ceding companies or their brokers. This information may be received on a monthly, quarterly or transactional basis and normally includes paid claims and estimates of case reserves. The Company sometimes also receives an estimate or provision for IBNR. This information is updated and adjusted periodically during the loss settlement period as new data or facts in respect of initial claims, client accounts, industry or event trends may be reported or emerge in addition to changes in applicable statutory and case laws.

The Company's estimates of large losses are based on factors including currently available information derived from claims information from certain customers and brokers, industry assessments of losses, proprietary models, and the terms and conditions of the Company's contracts. The uncertainty of the Company's estimates for large losses is also impacted by the preliminary nature of the information available, the magnitude and relative infrequency of the events, the expected duration of the respective claims development period, inadequacies in the data provided to the relevant date by industry participants and the potential for further reporting lags or insufficiencies; and in certain large losses, significant uncertainty as to the form of the claims and legal issues, under the relevant terms of insurance and reinsurance contracts. In addition, a significant portion of the net claims and claim expenses associated with certain large losses can be concentrated with a few large clients and therefore the loss estimates for these large losses may vary significantly based on the claims experience of those clients. The contingent nature of business interruption and other exposures will also impact losses in a meaningful way, which may give rise to significant complexity in respect of claims handling, claims adjustment and other coverage issues, over time. Given the magnitude of certain events, there can be meaningful uncertainty regarding total covered losses for the insurance industry and, accordingly, several of the key assumptions underlying the Company's loss estimates. Loss reserve estimation in respect of the Company's retrocessional contracts poses further challenges compared to directly assumed reinsurance. In addition, the Company's actual net losses from these events may increase if the Company's reinsurers or other obligors fail to meet their obligations.

The Company reevaluates its actuarial reserving techniques on a periodic basis. Typically, the quarterly review procedures include reviewing paid and reported claims in the most recent reporting period, reviewing the development of paid and reported claims from prior periods, and reviewing the Company's overall experience by underwriting year and in the aggregate. The Company monitors its expected ultimate claims and claim expense ratios and expected claims reporting assumptions on a quarterly basis and compares them to its actual experience. These actuarial assumptions are generally reviewed annually, based on input from actuaries, underwriters, claims personnel and finance professionals, although adjustments may be made more frequently if needed. Assumption changes are made to adjust for changes in the pricing and terms of coverage the Company provides, changes in industry results for similar business, as well as its actual experience to the extent the Company has enough data to rely on its own experience. If the Company determines that adjustments to an earlier estimate are appropriate, such adjustments are recorded in the period in which they are identified.

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NOTE 6. RESERVE FOR CLAIMS AND CLAIM EXPENSES, cont'd.

Because of the inherent uncertainties discussed above, the Company has developed a reserving philosophy that attempts to incorporate prudent assumptions and estimates, and the Company has experienced favorable net development on prior accident years net claims and claim expenses in the past. However, there is no assurance that this favorable development on prior accident years net claims and claim expenses will occur in future periods.

Incurred and Paid Claims Development and Reserving Methodology

The Company writes high layer, non-U.S. property catastrophe excess of loss reinsurance contracts to insure insurance and reinsurance companies against natural and man-made catastrophes. Under these contracts, the Company indemnifies an insurer or reinsurer when its aggregate paid claims and claim expenses from a single occurrence of a covered peril exceeds the attachment point specified in the contract, up to an amount per loss specified in the contract. Generally, the Company's most significant exposure is to losses from earthquakes and various windstorms, although the Company is also exposed to claims arising from other man-made and natural catastrophes, such as tsunamis, winter storms, freezes, floods, fires, tornadoes, explosions and acts of terrorism. The Company's predominant exposure under such coverage is to property damage. However, other risks, including business interruption and other non-property losses, may also be covered under the Company's catastrophe contracts when arising from a covered peril. The Company's coverages are offered on non-US selected geographic areas.

Coverage can also vary from "all property" perils to limited coverage on selected perils, such as "earthquake only" coverage. The Company also enters into retrocessional contracts that provide property catastrophe coverage to other reinsurers or retrocedants. This coverage is in the form of excess of loss retrocessional contracts and may cover all perils and exposures or be limited in scope to selected geographic areas, perils and/or exposures. The exposures the Company assumes from retrocessional business can change within a contract term as the underwriters of a retrocedant may alter their book of business after the retrocessional coverage has been bound.

Claims and claim expenses are generally characterized by losses of low frequency and high severity. Initial reporting of paid and incurred claims in general, tends to be relatively prompt, particularly for less complex losses. The Company considers this business "short-tail" as compared to the reporting of claims for "long-tail" products, which tends to be slower. However, the timing of claims payment and reporting also varies depending on various factors, including: whether the claims arise under reinsurance of primary insurance companies or reinsurance of other reinsurance companies; the nature of the events (e.g., windstorms, earthquakes or terrorism); the geographic area involved; post-event inflation which may cause the cost to repair damaged property to increase significantly from current estimates, or for property claims to remain open for a longer period of time, due to limitations on the supply of building materials, labor and other resources; complex policy coverage and other legal issues; and the quality of each client's claims management and reserving practices. Management's judgments regarding these factors are reflected in the Company's reserve for claims and claim expenses.

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NOTE 6. RESERVE FOR CLAIMS AND CLAIM EXPENSES, cont'd.

Claims and claim expense reserves are estimated by management by completing an in-depth analysis of the individual contracts which may potentially be impacted by the loss. The in-depth analysis generally involves: 1) estimating the size of insured industry losses; 2) reviewing reinsurance contract portfolios to identify contracts which are exposed; 3) reviewing information reported or otherwise provided by customers and brokers; 4) discussing the loss with customers and brokers; and 5) estimating the ultimate expected cost to settle all claims and administrative costs arising from the loss on a contract-by-contract basis and in aggregate for the event. Once a loss has occurred, during the then current reporting period, the Company records its best estimate of the ultimate expected cost to settle all claims arising from the loss. The Company's estimate of claims and claim expense reserves is then determined by deducting cumulative paid losses from its estimate of the ultimate expected loss. The Company's estimate of IBNR is determined by deducting cumulative paid losses, case reserves and additional case reserves from its estimate of the ultimate expected loss. Once the Company receives a valid notice of loss or payment request under a catastrophe reinsurance contract, it is generally able to process and pay such claims promptly.

Because the losses from which claims arise under policies written are typically prominent, public events such as earthquakes, the Company is often able to use independent reports as part of its loss reserve estimation process. The Company also reviews catastrophe bulletins published by various statistical reporting agencies to assist in determining the size of the industry loss, although these reports may not be available for some time after an event.

In general, reserves for the Company's more recent reinsured large losses are subject to greater uncertainty and, therefore, greater potential variability, and are likely to experience material changes from one period to the next. This is due to the uncertainty as to the size of the industry losses, uncertainty as to which contracts have been exposed, uncertainty due to complex legal and coverage issues that can arise out of large or complex losses, and uncertainty as to the magnitude of claims incurred by the Company's customers. As the Company's claims age, more information becomes available and the Company believes its estimates become more certain.

The information provided herein about incurred and paid accident year claims development for the years ended prior to December 31, 2020 is presented as supplementary information. For incurred and paid accident year claims denominated in foreign currency, the Company used the current year-end balance sheet foreign exchange rate for all periods provided, thereby eliminating the effects of changes in foreign currency translation rates from the incurred and paid accident year claims development information included in the tables below.

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NOTE 6. RESERVE FOR CLAIMS AND CLAIM EXPENSES, cont'd.

The following table details the Company's incurred claims and claim expenses and cumulative paid claims and claim expenses as of December 31, 2020, net of reinsurance, as well as IBNR and additional case reserves included within the net incurred claims amounts.

Incurred claims and claim expenses, net of reinsurance										
For the year ended December 31,										
Accident Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
	(unaudited)	(unaudited)	(unaudited)	(unaudited)	(unaudited)	(unaudited)	(unaudited)	(unaudited)	(unaudited)	(unaudited)
2011	\$ 5,309	\$ 5,309	\$ 5,309	\$ 5,309	\$ 5,309	\$ 46,792	\$ 46,792	\$ 46,792	\$ 46,792	\$ 46,792
2012	—	—	—	—	—	—	—	—	—	—
2013	—	—	—	—	—	—	—	—	—	—
2014	—	—	—	—	—	—	—	—	—	—
2015	—	—	—	—	—	—	—	—	—	—
2016	—	—	—	—	—	—	—	—	—	—
2017	—	—	—	—	—	—	—	—	—	—
2018	—	—	—	—	—	—	—	—	—	—
2019	—	—	—	—	—	—	—	—	—	—
2020	—	—	—	—	—	—	—	—	—	—
Total										<u>\$ 46,792</u>
Cumulative paid claims and claim expenses, net of reinsurance										
For the year ended December 31,										
Accident Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
	(unaudited)	(unaudited)	(unaudited)	(unaudited)	(unaudited)	(unaudited)	(unaudited)	(unaudited)	(unaudited)	(unaudited)
2011	\$ 3,952	\$ 27,943	\$ 46,792	\$ 46,792	\$ 46,792	\$ 46,792	\$ 46,792	\$ 46,792	\$ 46,792	\$ 46,792
2012	—	—	—	—	—	—	—	—	—	—
2013	—	—	—	—	—	—	—	—	—	—
2014	—	—	—	—	—	—	—	—	—	—
2015	—	—	—	—	—	—	—	—	—	—
2016	—	—	—	—	—	—	—	—	—	—
2017	—	—	—	—	—	—	—	—	—	—
2018	—	—	—	—	—	—	—	—	—	—
2019	—	—	—	—	—	—	—	—	—	—
2020	—	—	—	—	—	—	—	—	—	—
Total										46,792
										All outstanding liabilities before 2011, net of reinsurance
										4,970
										Liability for claims and claim expenses, net of reinsurance
										<u>\$ 4,970</u>

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NOTE 6. RESERVE FOR CLAIMS AND CLAIM EXPENSES, cont'd.

Prior Year Development of the Reserve for Net Claims and Claim Expenses

The Company's estimates of claims and claim expense reserves are not precise in that, among other things, they are based on predictions of future developments and estimates of future trends and other variable factors. Some, but not all, of the Company's reserves are further subject to the uncertainty inherent in actuarial methodologies and estimates. Because a reserve estimate is simply an insurer's estimate at a point in time of its ultimate liability, and because there are numerous factors that affect reserves and claims payments that cannot be determined with certainty in advance, the Company's ultimate payments will vary, perhaps materially, from its estimates of reserves. If the Company determines in a subsequent period that adjustments to its previously established reserves are appropriate, such adjustments are recorded in the period in which they are identified. On a net basis, the Company's cumulative favorable or unfavorable development is generally reduced by offsetting changes in its reinsurance recoverable, as well as changes to loss related premiums such as reinstatement premiums.

Given the magnitude of the Tohoku and New Zealand Earthquakes, the contingent nature of business interruption and other exposures, potential uncertainties relating to reinsurance recoveries and other uncertainties inherent in loss estimation, meaningful uncertainty remains regarding losses from this event. In addition, a significant portion of the Company's potential exposures associated with the Tohoku and New Zealand Earthquakes are concentrated with a few large clients and therefore the loss estimates for these events may vary significantly based on the claims experience of those clients.

In 2020 and 2019, the Company experienced no development of prior accident years net claims and claim expenses. In 2020, the Company made net payments of \$1.4 million (2019 - \$1.5 million) on prior accident years net claims and claim expenses associated with the 2010 New Zealand Earthquake.

Reconciliation of the Disclosure of Incurred and Paid Claims Development to the Reserve for Claims and Claim Expenses

The reconciliation of the net incurred and paid claims development tables to the reserve for claims and claim expenses in the consolidated balance sheet is as follows:

At December 31, 2020	
Net reserve for claims and claim expenses	\$ 4,970
Reinsurance recoverable	—
Reserve for claims and claim expenses	<u>\$ 4,970</u>

Historical Claims Duration

The following is unaudited supplementary information about average historical claims duration:

At December 31, 2020	Average annual percentage payout of incurred claims by age, net of reinsurance (number of years)									
	1	2	3	4	5	6	7	8	9	10
	8.4 %	51.3 %	40.3 %	— %	— %	— %	— %	— %	— %	— %

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NOTE 6. RESERVE FOR CLAIMS AND CLAIM EXPENSES, cont'd.

Claims Frequency

The Company's business is broadly considered to be assumed reinsurance, where multiple claims are often aggregated, perhaps multiple times through retrocessional reinsurance, before ultimately being ceded to the Company. In addition, the nature, size, terms and conditions of contracts entered into by the Company, changes from one accident year to the next and the quantum of contractual or policy limits, and accordingly the potential amount of claims and claim expenses associated with a reported claim, can range from nominal, to significant. These factors can impact the amount and timing of the claims and claim expenses to be recorded and accordingly, developing claim frequency information is highly subjective and is not prepared or utilized for internal purposes.

Notwithstanding the factors noted above, the Company has developed claims frequency information associated with its excess of loss reinsurance contracts. As each accident year develops, the Company would expect the cumulative number of reported claims to increase in certain of its excess of loss reinsurance contracts. In determining claims frequency for its excess of loss reinsurance contracts, the Company has made the following assumptions:

- Claims below the insured layer of a contract are excluded;
- If an insured loss event results in claims associated with a number of layers of a contract, the Company would consider this to be a single claim.

The following table details the Company's cumulative number of reported claims for its excess of loss reinsurance contracts:

Accident Year	At December 31, 2020
	Cumulative number of reported claims
2011	1
2012	—
2013	—
2014	—
2015	—
2016	—
2017	—
2018	—
2019	—
2020	—

NOTE 7. SHAREHOLDERS' EQUITY

The Company was incorporated with authorized capital of 120,000 common shares with a par value of \$1.00 divided into three separate classes: 60,000 Class A shares, 27,692 Class B (non-voting common) shares and 32,308 Class C shares. The amount paid in excess of the par value is shown as additional paid-in capital.

During 2020, the Company declared and paid a dividend of \$17.8 million and returned additional paid-in capital of \$18.2 million on a pro rata basis to its shareholders in cash.

During 2019, the Company declared and paid a dividend of \$17.5 million and returned additional paid-in capital of \$22.5 million on a pro rata basis to its shareholders in cash.

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NOTE 7. SHAREHOLDERS' EQUITY, cont'd.

See "Note 13. Subsequent Events" for additional information related to a dividend and return of additional paid-in capital subsequent to December 31, 2020.

NOTE 8. RELATED PARTY TRANSACTIONS AND MAJOR CUSTOMERS

Amounts due to and from affiliates are non-interest bearing and payable on demand. Amounts due to and from State Farm under the stop-loss contract are non-interest bearing and payable in accordance with the terms of the underlying stop-loss contract.

Reinsurance-Related Transactions

The Company has in place a stop-loss contract with State Farm. See "Note 5. Reinsurance" for additional information related to the stop-loss contract.

Other Items

Under the terms of an Administration Agreement, Renaissance Underwriting Managers Ltd. ("RUM") or related entities, provide all of the Company's management, underwriting and administrative functions, and the Company reimburses RUM for its administrative services, office lease and other expenses at a fixed percentage of gross premiums written. For the year ended December 31, 2020, such costs and expenses incurred by the Company were \$2.4 million (2019 - \$2.3 million). At December 31, 2020, the Company had an outstanding payable to RUM of \$0.7 million (2019 - \$0.6 million).

Major Customers

During the years ended December 31, 2020 and 2019, the Company received 100.0% of its gross premiums written from three reinsurance brokers. Subsidiaries and affiliates of Aon plc, Marsh Inc. and Willis Towers Watson Public Limited Company accounted for approximately 88.5%, 5.8% and 5.7%, respectively, of the Company's gross premiums written in 2020 (2019 - 94.2%, and 1.8% and 4.0%, respectively).

NOTE 9. TAXATION

Under current Bermuda law, the Company is not subject to any income or capital gains taxes. In the event that such taxes are imposed, the Company would be exempted from any such tax until March 2035 pursuant to the Bermuda Exempted Undertakings Tax Protection Act of 1966, and Amended Act of 1987 and 2011, respectively.

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NOTE 10. STATUTORY REQUIREMENTS

Bermuda Statutory Requirements

The Company is subject to insurance laws and regulations in Bermuda. These regulations include certain restrictions on the amount of dividends or other distributions, such as loans or cash advances, available to shareholders without prior approval of the Bermuda Monetary Authority (“BMA”). Under the Insurance Act 1978, amendments thereto and related regulations of Bermuda (collectively, the “Insurance Act”), the Company is required to prepare statutory financial statements. The Insurance Act also requires the Company to ensure that it can meet its minimum solvency margin, defined as the minimum amount by which the value of the assets of the Company must exceed the value of its liabilities, the breach of which represents an unacceptable level of risk and triggers the strongest supervisory actions.

In addition, the Company is required to maintain statutory capital and surplus at a level equal to or in excess of its enhanced capital requirement (“ECR”) which is established by reference to the Bermuda Solvency Capital Requirement (the “BSCR”) model. The BSCR is a mathematical model designed to give the BMA robust methods for determining an insurer’s capital adequacy. The ECR is equal to the greater of the minimum solvency margin or required capital calculated by reference to the BSCR. The Economic Balance Sheet (“EBS”) is an input to the BSCR and determines the Company’s statutory capital and surplus. The EBS regime prescribes the use of financial statements prepared in accordance with GAAP as the basis on which statutory financial statements are prepared, and those statutory financial statements form the starting basis for the EBS. The BMA has established a target capital level (“TCL”) which is set at 120% of the ECR. While the Company is not required to maintain statutory capital and surplus at this level, it serves as an early warning tool for the BMA, and failure to meet the target capital level may result in additional reporting requirements or increased regulatory oversight. The Company is currently completing its 2020 BSCR, which must be filed with the BMA on or before April 30, 2021. At this time, the Company believes it will meet the April 30, 2021 filing deadline and exceed the TCL.

Underlying the BSCR is the belief that all insurers should operate on an ongoing basis with a view to maintaining their capital at a prudent level in excess of the minimum solvency margin otherwise prescribed under the Insurance Act. Alternatively, under the Insurance Act, insurers may, subject to the terms of the Insurance Act and to the BMA’s oversight, elect to utilize an approved internal capital model to determine regulatory capital. In either case, ECR shall at all times equal or exceed the insurer’s minimum solvency margin and may be adjusted in circumstances where the BMA concludes that the insurer’s risk profile deviates significantly from the assumptions underlying its ECR or the insurer’s assessment of its risk management policies and practices used to calculate ECR applicable to it.

Under the Insurance Act, the Company is defined as a Class 3A insurer. Class 3A insurers are prohibited from declaring or paying any dividends if in breach of the required minimum solvency margin or minimum liquidity ratio (the “Relevant Margins”) or if the declaration or payment of such dividend would cause the insurer to fail to meet the Relevant Margins. Where an insurer fails to meet its Relevant Margins on the last day of any financial year, it is prohibited from declaring or paying any dividends during the next financial year without the prior approval of the BMA. Further, Class 3A insurers are prohibited from declaring or paying in any financial year 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 BMA an affidavit stating that it will continue to meet its Relevant Margins. Class 3A insurers must obtain the BMA’s prior approval for a reduction by 15% or more of the total statutory capital as set forth in its previous year’s statutory financial statements. These restrictions on declaring or paying dividends and distributions under the Insurance Act are in addition to the solvency requirements under the Companies Act 1981, amendments thereto of Bermuda (the “Companies Act”) which apply to all Bermuda companies. In addition, an insurer engaged in general business is also required to maintain the value of its relevant assets at not less than 75% of the amount of its relevant liabilities.

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NOTE 10. STATUTORY REQUIREMENTS, cont'd.

The statutory capital and surplus, required minimum statutory capital and surplus and unrestricted net assets of the Company are detailed below:

<u>At December 31,</u>	<u>2020</u>	<u>2019</u>
Statutory capital and surplus (1)	\$ 128,918	\$ 145,728
Required statutory capital and surplus	15,486	16,094
Unrestricted net assets (2)	25,619	40,376

- (1) Actual capital and surplus is based on the relevant insurer's statutory financial statements and required statutory capital and surplus is based on the minimum solvency margin.
- (2) Unrestricted net assets represents the amount of shareholders' equity that is permitted to be distributed in light of the statutory restrictions noted above, and the definition of distributable reserves and certain legal restrictions per the Companies Act.

Statutory capital includes \$75.0 million of letters of credit pledged by the Company's shareholders as other fixed capital. See "Note 12. Commitments and Contingencies" for additional information relating to the letters of credit pledged by the Company's shareholders.

NOTE 11. DERIVATIVE INSTRUMENTS

From time to time, the Company may enter into derivative instruments such as forward contracts primarily to manage its foreign currency exposure or obtain exposure. The Company's derivative instruments can be exchange traded or over-the-counter, with over-the-counter derivatives generally traded under International Swaps and Derivatives Association master agreements, which establish the terms of the transactions entered into with the Company's derivative counterparties. In the event a party becomes insolvent or otherwise defaults on its obligations, a master agreement generally permits the non-defaulting party to accelerate and terminate all outstanding transactions and net the transactions' marked-to-market values so that a single sum in a single currency will be owed by, or owed to, the non-defaulting party. Effectively, this contractual close-out netting reduces credit exposure from gross to net exposure. Where the Company has entered into master netting agreements with counterparties, or the Company has the legal and contractual right to offset positions, the derivative positions are generally netted by counterparty and are reported accordingly in other assets and other liabilities.

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NOTE 11. DERIVATIVE INSTRUMENTS, cont'd.

The tables below show the gross and net amounts of recognized derivative assets and liabilities at fair value, including the location on the balance sheets of the Company's principal derivative instruments:

Derivative Assets						
<u>At December 31, 2020</u>	Gross Amounts of Recognized Assets	Gross Amounts Offset in the Balance Sheet	Net Amounts of Assets Presented in the Balance Sheet	Balance Sheet Location	Collateral	Net Amount
Foreign currency forward contracts	\$ 326	\$ —	\$ 326	Other assets	\$ —	\$ 326
Derivative Liabilities						
<u>At December 31, 2020</u>	Gross Amounts of Recognized Liabilities	Gross Amounts Offset in the Balance Sheet	Net Amounts of Liabilities Presented in the Balance Sheet	Balance Sheet Location	Collateral Pledged	Net Amount
Foreign currency forward contracts	\$ 431	\$ —	\$ 431	Other liabilities	\$ —	\$ 431

Derivative Assets						
<u>At December 31, 2019</u>	Gross Amounts of Recognized Assets	Gross Amounts Offset in the Balance Sheet	Net Amounts of Assets Presented in the Balance Sheet	Balance Sheet Location	Collateral	Net Amount
Foreign currency forward contracts	\$ 128	\$ —	\$ 128	Other assets	\$ —	\$ 128
Derivative Liabilities						
<u>At December 31, 2019</u>	Gross Amounts of Recognized Liabilities	Gross Amounts Offset in the Balance Sheet	Net Amounts of Liabilities Presented in the Balance Sheet	Balance Sheet Location	Collateral Pledged	Net Amount
Foreign currency forward contracts	\$ 142	\$ —	\$ 142	Other liabilities	\$ —	\$ 142

The location and amount of the (loss) gain recognized in the Company's statements of operations related to the Company's principal derivative instruments are shown in the following table:

<u>Year ended December 31,</u>	Location of (loss) gain recognized on derivatives	Amount of (loss) gain recognized on derivatives	
		2020	2019
Foreign currency forward contracts	Net foreign exchange gains	\$ (91)	\$ 164

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NOTE 11. DERIVATIVE INSTRUMENTS, cont'd.

Foreign Currency Derivatives

The Company's functional currency is the U.S. dollar. The Company writes a portion of its business in currencies other than U.S. dollars and may, from time to time, experience foreign exchange gains and losses in the Company's financial statements. All changes in exchange rates, with the exception of non-monetary assets and liabilities, are recognized in the Company's statements of operations. Changes in the fair value of the Company's foreign currency derivatives are recognized in the statements of operations.

Underwriting and Non-Investments Operations Related Foreign Currency Contracts

The Company's foreign currency policy with regard to its underwriting operations is generally to hold foreign currency assets, including cash, investments and receivables that approximate the foreign currency liabilities, including claims and claim expense reserves and reinsurance balances payable. When necessary, the Company may use foreign currency forward and option contracts to minimize the effect of fluctuating foreign currencies on the value of non-U.S. dollar denominated assets and liabilities associated with its underwriting operations. The fair value of the Company's underwriting operations related foreign currency contracts is determined using indicative pricing obtained from counterparties or broker quotes. At December 31, 2020, the Company had outstanding underwriting related foreign currency contracts of \$10.6 million in notional long positions and \$12.1 million in notional short positions, denominated in U.S. dollars (2019 - \$21.5 million and \$19.0 million, respectively).

NOTE 12. COMMITMENTS AND CONTINGENCIES

Concentration of Credit Risk

Financial instruments, which potentially subject the Company to concentration of credit risk, consist principally of investments and cash. Except for U.S. treasuries, none of the Company's investments exceeded 10% of shareholders' equity at December 31, 2020. See "Note 5. Reinsurance" for additional information with respect to reinsurance recoverable.

Letters of Credit and Other Commitments

The Company is the beneficiary of \$75.0 million of letters of credit issued on behalf of Renaissance Reinsurance and State Farm. These letters of credit can be drawn by the Company if a capital call resulting from a claim is not funded by either Renaissance Reinsurance or State Farm.

The Company is also the beneficiary of a \$100.0 million mandatory additional capital contribution agreement issued by Renaissance Reinsurance and State Farm. In the event that a loss reduces the Company's capital below a specified level, the Company can call on both Renaissance Reinsurance and State Farm to contribute additional capital as needed, up to a maximum of \$50.0 million each.

Indemnifications and Warranties

In the ordinary course of its business, the Company may enter into contracts or agreements that contain indemnifications or warranties. Future events could occur that lead to the execution of these provisions against the Company. Based on past experience, management currently believes that the likelihood of such an event is remote.

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NOTE 12. COMMITMENTS AND CONTINGENCIES, cont'd.

Litigation

The Company is subject to lawsuits and regulatory actions in the normal course of business that do not arise from or directly relate to claims on reinsurance treaties or contracts or direct surplus lines insurance policies. In the Company's industry, business litigation may involve allegations of underwriting or claims-handling errors or misconduct, regulatory actions or other disputes. The Company may also directly or indirectly be subject to claims litigation involving, among other things, disputed interpretations of policy coverages. In addition, the Company may from time to time engage in litigation or arbitration related to claims for payment in respect of ceded reinsurance, including disputes that challenge the Company's ability to enforce its underwriting intent. Such matters could result, directly or indirectly, in providers of protection not meeting their obligations to the Company or not doing so on a timely basis. The Company may also be subject to other disputes from time to time, relating to operational or other matters distinct from insurance or reinsurance claims. Any litigation or arbitration, or regulatory process, contains an element of uncertainty, and the value of an exposure or a gain contingency related to a dispute is difficult to estimate accordingly. Currently, the Company believes that no individual litigation or arbitration to which the Company is presently a party is likely to have a material adverse effect on the Company's financial condition, business or results of operations.

NOTE 13. SUBSEQUENT EVENTS

On February 23, 2021, the Company declared a dividend of \$13.5 million and a return of additional paid-in capital of \$5.2 million on a pro rata basis to its shareholders, both of which were paid in March 2021.

The Company has completed its subsequent events evaluation for the period subsequent to the balance sheet date of December 31, 2020, through April 26, 2021, the date the financial statements were available to be issued.