

THE HANOVER ATLANTIC INSURANCE COMPANY LTD.

Financial Statements and Related Notes

December 31, 2021 and 2020



Report of Independent Auditors

To the Board of Directors of The Hanover Atlantic Insurance Company Ltd.

Opinion

We have audited the accompanying financial statements of The Hanover Atlantic Insurance Company Ltd. (the "Company"), which comprise the balance sheets as of December 31, 2021 and 2020, and the related statements of income, of comprehensive income, of stockholders' equity and of cash flows for the years then ended, including the related notes (collectively referred to as the "financial statements").

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2021 and 2020, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (US GAAS). Our responsibilities under those standards are further described in the Auditors' Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of the Company and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the Company's ability to continue as a going concern for one year after the date the financial statements are available to be issued.

Auditors' Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with US GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with US GAAS, we:



- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit 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 Company's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about the Company's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control-related matters that we identified during the audit.

A handwritten signature in black ink, appearing to read "PricewaterhouseCoopers LLP", written in a cursive style.

Boston, Massachusetts
April 22, 2022

THE HANOVER ATLANTIC INSURANCE COMPANY LTD.

Balance Sheets

(In thousands, except share data)

	December 31,	
Assets	2021	2020
Fixed maturities, at fair value (amortized cost of \$48,243 and \$47,185)	\$ 49,341	\$ 50,008
Cash and cash equivalents	837	964
Accrued investment income	337	335
Premiums receivable, net	22,388	7,855
Reinsurance recoverable on unpaid losses and unearned premiums	52,468	24,948
Total assets	\$ 125,371	\$ 84,110
Liabilities and Stockholder's Equity		
Loss and loss adjustment expense reserves	\$ 20,667	\$ 8,661
Unearned premiums	31,801	16,287
Reinsurance payable to affiliate	22,388	7,855
Accounts payable and accrued expenses	8	29
Deferred federal income tax liability	258	612
Total liabilities	75,122	33,444
Stockholder's equity:		
Common stock, \$1.00 par value; authorized 120,000 shares; issued 120,000 shares	120	120
Additional paid-in capital	46,880	46,880
Retained earnings	2,382	1,436
Accumulated other comprehensive income	867	2,230
Total stockholder's equity	50,249	50,666
Total liabilities and stockholder's equity	\$ 125,371	\$ 84,110

The accompanying notes are an integral part of these financial statements.

THE HANOVER ATLANTIC INSURANCE COMPANY LTD.
Statements of Income

(In thousands)	December 31,	
	2021	2020
Revenues:		
Net investment income	\$ 1,178	\$ 1,232
Net realized investment gains	20	174
Total revenues	1,198	1,406
Income tax expense	252	295
Net income	\$ 946	\$ 1,111

The accompanying notes are an integral part of these financial statements.

THE HANOVER ATLANTIC INSURANCE COMPANY LTD.
Statements of Comprehensive Income

(In thousands)

	December 31,	
	2021	2020
Net income	\$ 946	\$ 1,111
Other comprehensive (loss) income:		
Available-for-sale securities:		
Net (depreciation) appreciation during the period	(1,725)	1,894
Benefit (provision) for deferred income taxes	362	(398)
Total available-for-sale securities	(1,363)	1,496
Other comprehensive (loss) income, net of tax	(1,363)	1,496
Comprehensive (loss) income	\$ (417)	\$ 2,607

The accompanying notes are an integral part of these financial statements.

THE HANOVER ATLANTIC INSURANCE COMPANY LTD.
Statements of Stockholder's Equity

(In thousands)

	<u>Common Stock</u>	<u>Additional paid-in capital</u>	<u>Retained earnings</u>	<u>Accumulated other comprehensive income</u>	<u>Total stockholder's equity</u>
Balances at December 31, 2019	\$ 120	\$ 46,880	\$ 3,325	\$ 734	\$ 51,059
Net income			1,111		1,111
Dividends to Shareholders			(3,000)		(3,000)
Appreciation on available-for-sale securities net of tax provision of \$398				1,496	1,496
Balances at December 31, 2020	<u>\$ 120</u>	<u>\$ 46,880</u>	<u>\$ 1,436</u>	<u>\$ 2,230</u>	<u>\$ 50,666</u>
Net income			946		946
Depreciation on available-for-sale securities net of tax benefit of \$362				(1,363)	(1,363)
Balances at December 31, 2021	<u>\$ 120</u>	<u>\$ 46,880</u>	<u>\$ 2,382</u>	<u>\$ 867</u>	<u>\$ 50,249</u>

The accompanying notes are an integral part of these financial statements.

THE HANOVER ATLANTIC INSURANCE COMPANY LTD.
Statements of Cash Flows

(In thousands)

	December 31,	
	2021	2020
Cash flows from operating activities:		
Net income	\$ 946	\$ 1,111
Adjustments to reconcile net income to net cash used in operating activities:		
Change in accrued investment income	(2)	31
Deferred federal income tax benefit	8	56
Change in federal income tax recoverable	—	14
Change in accounts payable and accrued expenses	(21)	(375)
Net amortization of long-term bonds	169	318
Net realized loss of available for-sale fixed maturities	(20)	(174)
Net cash provided by operating activities	1,080	981
Cash flows from investing activities:		
Purchase of available-for-sale fixed maturities	(8,354)	(10,688)
Disposal of available-for-sale fixed maturities	7,147	8,892
Net cash (used) provided in investing activities	(1,207)	(1,796)
Cash flows from financing activities:		
Dividends paid to shareholders	—	(39)
Net cash used by financing activities	—	(39)
Net decrease in cash	(127)	(854)
Cash and cash equivalents at beginning of year	964	1,818
Cash and cash equivalents at end of year	\$ 837	\$ 964
 Supplemental Disclosure of Cash Flow Information:		
Income taxes paid	\$266	\$200

See note (9) for related party non-cash dividend

The accompanying notes are an integral part of these financial statements.

The Hanover Atlantic Insurance Company Ltd.
Notes to Financial Statements

(1) Organization and Operations

The Hanover Atlantic Insurance Company Ltd. (the “Company”) was incorporated under the laws of Bermuda on April 15, 2016 and began operations in May, 2016. The company is a wholly owned subsidiary of The Hanover Insurance Company (“Hanover”). Hanover is a wholly-owned subsidiary of Opus Investment Management, Inc. (“Opus”), which, in turn, is a wholly-owned non-insurance subsidiary of The Hanover Insurance Group, Inc. (“THG”). The Company holds a Class 3A license under the Bermuda Insurance Act of 1978 and Related Regulations as amended (the “Act”).

The Company operates primarily as an excess and surplus lines property and casualty insurance company writing direct business in the U.S market. In addition, the Company entered into a quota-share reinsurance contract with Royal Sun Alliance (“RSA”), whereby RSA cedes up to 100% of certain international property and liability premiums and losses and loss adjustment expenses (“LAE”). All Company direct and assumed premiums, losses and LAE and underwriting expenses are ceded 100% to Hanover in accordance with an intercompany reinsurance agreement.

(2) Summary of Significant Accounting Policies

A summary of the significant accounting policies of the Company follows:

(a) Basis of Presentation

The preparation of financial statements in conformity with generally accepted accounting principles in the United States of America (“U.S. GAAP”) requires the Company 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 amount of revenues and expenses during the reporting period. Actual results could differ from those estimates.

All amounts shown herein are in thousands unless otherwise noted.

(b) Investments

Fixed maturity securities are classified as available-for-sale and are carried at fair value, with unrealized gains and losses, net of taxes, reported in accumulated other comprehensive income (“AOCI”), a separate component of stockholder’s equity. The amortized cost of fixed maturities is adjusted for amortization of premiums and accretion of discounts to maturity.

The Company excludes accrued interest receivable from both the estimated fair value and the amortized cost basis of its investment securities and reports such amounts separately on the balance sheets as accrued investment income. When accrued interest receivable is deemed uncollectible it is written off as a charge to investment income, rather than recorded through an allowance.

Net investment income includes interest income which is recognized based on the effective yield method and includes the amortization of premiums and accretion of discounts. The effective yield used to determine the amortization for fixed maturities subject to prepayment risk, such as mortgage-backed and asset-backed securities, is recalculated and adjusted periodically based upon actual historical and projected future cash flows. The adjustment to yields for highly rated prepayable fixed maturities is accounted for using the retrospective method. The adjustment to yields for all other prepayable fixed maturities is accounted for using the prospective method. Fixed maturities that are delinquent are placed on non-accrual status, and thereafter interest income is recognized only when cash payments are received.

Realized investment gains and losses on sales are reported as a component of revenues based upon specific identification of the investment assets sold. Impairments are reported as realized investment losses, and include credit losses (and any subsequent recoveries) and intend-to-sell impairment losses on fixed maturities.

The Hanover Atlantic Insurance Company Ltd.
Notes to Financial Statements

The Company reviews fixed maturity securities in an unrealized loss position and assesses whether it intends to sell the security or more likely than not will be required to sell the security before the recovery of its amortized cost basis. If the debt security meets either of these two criteria, an intend-to-sell impairment is recognized in earnings equal to the entire difference between the security's amortized cost basis and its fair value at the impairment measurement date. If neither of the above criteria are met, the credit loss portion of the unrealized loss is recorded through earnings and the non-credit portion remains in other comprehensive income. Credit losses are estimated by comparing the amortized cost of the fixed maturity security with the net present value of the security's projected future cash flows, discounted at the effective interest rate implicit in the investment prior to impairment. The non-credit portion of the impairment is equal to the difference between the fair value and the net present value of the security's cash flows at the impairment measurement date. Beginning January 1, 2020, credit losses are recorded through an allowance for credit losses rather than an adjustment to amortized cost. Recoveries of impairments on fixed maturities are recognized as reversals of the allowance for credit loss and are no longer accreted as investment income through an adjustment to investment yield. The allowance for credit losses is limited to the amount that fair value is less than amortized cost and therefore, increases in the fair value of investments due to reasons other than credit could result in decreases in the allowance and an increase in net income.

(c) Cash and Cash Equivalents

Cash and cash equivalents include cash on hand, amounts due from banks and highly liquid debt instruments purchased with an original maturity of three months or less.

(d) Deferred Policy Acquisition Costs

Acquisition costs consist of commissions, underwriting costs and other costs, which vary with, and are primarily related to, the successful production of premiums. Acquisition costs are deferred and amortized over the terms of the insurance policies.

Deferred acquisition costs ("DAC") for each line of business are reviewed to determine if the costs are recoverable from future income, including investment income. If such costs are determined to be unrecoverable, they are expensed at the time of determination. Although recoverability of DAC is not assured, the Company believes it is more likely than not that all of these costs will be recovered. The amount of DAC considered recoverable, however, could be reduced in the near term if the estimates of total revenues discussed above are reduced or permanently impaired as a result of a disposition of a line of business. The amount of amortization of DAC could be revised in the near term if any of the estimates discussed above are revised.

All acquisition costs incurred by the Company are ceded 100% to Hanover in accordance with an intercompany reinsurance agreement. As a result, DAC is presented on the financial statements net of ceding commissions. The gross DAC and ceded DAC balance for the years ended December 31, 2021 and 2020, was \$5,405 and \$2,380, respectively.

(e) Liabilities for Losses, LAE and Unearned Premiums

Liabilities for outstanding claims, losses and LAE are estimates of payments to be made for reported losses and LAE and estimates of losses and LAE incurred but not reported ("IBNR"). These liabilities are determined using case basis evaluations and statistical analyses of historical loss patterns and represent estimates of the ultimate cost of all losses incurred but not paid. These estimates are continually reviewed and adjusted as necessary; adjustments are reflected in current operations. Estimated amounts of salvage and subrogation on unpaid losses are deducted from the liability for unpaid claims.

Premiums for direct and assumed business are reported as earned on a pro-rata basis over the contract period. The unexpired portion of these premiums is recorded as unearned premiums.

The Hanover Atlantic Insurance Company Ltd.
Notes to Financial Statements

All losses, LAE and unearned premium liabilities are based on the various estimates discussed above. Although the adequacy of these amounts cannot be assured, the Company believes that it is more likely than not that these liabilities and accruals will be sufficient to meet future obligations of policies in force. The amount of liabilities and accruals, however, could be revised in the near-term if the estimates discussed above are revised.

(f) Premium Revenue

As a result of intercompany reinsurance, there are no net written or earned premiums reported in the statement of income for the years ended on December 31, 2021 or 2020.

Written premiums for the years ended December 31, 2021 and 2020 were as follows:

(In thousands)	2021	2020
Direct	\$ 60,084	\$ 25,698
Assumed	1,755	1,642
Ceded	(61,839)	(27,340)
Net	\$ -	\$ -

(g) Federal Income Taxes

The Company is subject to U.S. income taxation and in January 2017, it filed an election statement under the Internal Revenue Code section 953(d) with the IRS to be treated as a U.S. domestic corporation and included in the consolidated United States federal income tax return with THG and its domestic subsidiaries (including certain non-insurance operations). Bermuda does not impose an income or capital gains tax.

The Company's accounting for income taxes represents its best estimate of various events and transactions.

Deferred income taxes are generally recognized when assets and liabilities have different values for financial statement and tax reporting purposes, and for other temporary taxable and deductible differences as defined by ASC 740, *Income Taxes* ("ASC 740"). These temporary differences are measured at the balance sheet date using enacted tax rates expected to apply to taxable income in the years the temporary differences are expected to reverse. These differences result from the Company's investment portfolios.

The realization of deferred tax assets depends upon the existence of sufficient taxable income within the carryback or carryforward periods under the tax law in the applicable tax jurisdiction. Consideration is given to all available positive and negative evidence, including reversals of deferred tax liabilities, projected future taxable income, tax planning strategies and recent financial operations. Valuation allowances are established if, based on available information, it is determined that it is more likely than not that all or some portion of the deferred tax assets will not be realized.

Changes in valuation allowances are generally reflected in income tax expense or as an adjustment to other comprehensive income (loss) depending on the nature of the item for which the valuation allowance is being recorded.

The Hanover Atlantic Insurance Company Ltd.
Notes to Financial Statements

(h) New Accounting Pronouncements

Recently Implemented Standards

In October 2020, the FASB issued ASC Update No. 2020-08, *Codification Improvements to Subtopic 310-20, Receivables – Nonrefundable Fees and Other Costs*. This guidance clarifies, for each reporting period, that an entity should reevaluate whether a callable debt security with multiple call dates is required to amortize any premium to the next call date. The updated guidance is effective for annual and interim periods beginning after December 15, 2020 and should be applied on a prospective basis as of the beginning of the period of adoption for existing or newly purchased callable debt securities. The Company implemented this guidance effective January 1, 2021, and it did not have a material impact on its financial position or results of operations.

In December 2019, the FASB issued ASC Update No. 2019-12 *Income Taxes (Topic 740) – Simplifying the Accounting for Income Taxes*. This ASC update removes certain exceptions to the general principles in ASC 740, *Income Taxes*, including intraperiod tax allocation when there is a loss from continuing operations, foreign subsidiary treatment under certain conditions and for calculating interim income taxes when the year-to-date loss exceeds the anticipated loss. This update also clarifies and amends existing guidance related to changes in tax laws, business combinations and employee stock plans, among others. The updated guidance is effective for interim and annual periods beginning after December 15, 2020. Early adoption is permitted, including interim periods. The Company implemented this guidance effective January 1, 2021, and it did not have a material impact on its financial position or results of operations.

In August 2018, the FASB issued ASC Update No. 2018-13 (Topic 820) *Fair Value Measurement, Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement*. This update removes the requirement for disclosure of the following: 1) the amount and reasons for transfers between level 1 and level 2 of the fair value hierarchy, 2) the policy for timing of transfers between levels, and 3) the valuation processes for level 3 fair value measurements. This update also added a requirement to disclose the changes in unrealized gains and losses for the period included in other comprehensive income for recurring level 3 fair value measurements held at the end of the reporting period and the range and weighted average of significant unobservable inputs used to develop level 3 fair value measurements, in addition to other fair value disclosure modifications. This update required both prospective and retrospective application to certain disclosures upon implementation. The Company implemented this guidance effective January 1, 2020 and it did not have an impact on the Company's financial position or results of operations as the update is disclosure related.

In 2019 and 2020, the FASB issued several updates to ASC Update 2016-13, including the issuance in April 2019 of ASC Update 2019-04, *Codification Improvements to Topic 360, Financial Instruments – Credit Losses, Topic 815, Derivatives and Hedging and Topic 825, Financial Instruments*, the issuance in May 2019 of ASC Update 2019-05, *Financial Instruments – Credit Losses (Topic 326): Targeted Transition Relief*, the issuance in November 2019 of ASC Update No. 2019-11, *Codification Improvements to Topic 326, Financial Instruments – Credit Losses* and the issuance in February 2020 of ASC Update 2020-02, *Financial Instruments – Credit Losses (Topic 326) and Leases (Topic 842) – Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 119 and Update to SEC Section on Effective Date Related to Accounting Standards Update No. 2016-02, Leases (Topic 842)*. The Company implemented ASC Update No. 2016-13 and the related updates effective January 1, 2020 and it did not have a material impact on its financial position or results of operations.

The Hanover Atlantic Insurance Company Ltd.
Notes to Financial Statements

(3) Investments

The amortized cost and fair value of available-for-sale fixed maturities were as follows:

December 31, 2021

(In thousands)

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Treasury and government agencies	\$ 3,105	\$ 86	\$ (43)	\$ 3,148
Municipal	26,296	545	(179)	26,662
Corporate	13,579	621	(8)	14,192
Residential mortgage-backed	3,042	44	(15)	3,071
Commercial mortgage-backed	1,671	35	-	1,706
Asset-backed	550	12	-	562
Total fixed maturities	<u>\$ 48,243</u>	<u>\$ 1,343</u>	<u>\$ (245)</u>	<u>\$ 49,341</u>

December 31, 2020

(In thousands)

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Treasury and government agencies	\$ 3,957	\$ 194	\$ (11)	\$ 4,140
Municipal	20,228	1,073	-	21,301
Corporate	15,116	1,258	-	16,374
Residential mortgage-backed	5,300	174	-	5,474
Commercial mortgage-backed	1,834	106	-	1,940
Asset-backed	750	29	-	779
Total fixed maturities	<u>\$ 47,185</u>	<u>\$ 2,834</u>	<u>\$ (11)</u>	<u>\$ 50,008</u>

At December 31, 2021 and 2020, the Company had no allowance for credit losses.

In accordance with National Association of Insurance Commissioners International Insurers Department operating guidelines, the Company deposited funds into a trust account in a qualified U.S. financial institution which was held in trust for the benefit of U.S. policyholders. At December 31, 2021 and 2020, fixed maturities with a fair value of \$ 5,930 and \$6,121, respectively were on deposit with this trust.

The Hanover Atlantic Insurance Company Ltd.
Notes to Financial Statements

The amortized cost and fair value by maturity periods for fixed maturities are shown below. Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties, or the Company may have the right to put or sell the obligations back to the issuers.

December 31, 2021

(In thousands)

	Amortized Cost	Fair Value
Due in one year or less	\$ 2,273	\$ 2,289
Due after one year through five years	13,815	14,392
Due after five years through ten years	23,119	23,599
Due after ten years	3,773	3,722
	<u>42,980</u>	<u>44,002</u>
Mortgage-backed and asset-backed securities	5,263	5,339
Total fixed maturities	<u>\$ 48,243</u>	<u>\$ 49,341</u>

The following tables provide information about the Company's fixed maturities that were in an unrealized loss position, including the length of time the securities have been in an unrealized loss position.

December 31, 2021

(In thousands)

	12 months or less		Greater than 12 months		Total	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
Investment grade:						
U.S. Treasury and government agencies	\$ (15)	\$ 485	\$ (28)	\$ 453	\$ (43)	\$ 938
Municipal	(179)	11,359	-	-	(179)	11,359
Corporate	(8)	826	-	-	(8)	826
Residential mortgage-backed	(15)	735	-	-	(15)	735
Total fixed maturities	<u>\$ (217)</u>	<u>\$ 13,405</u>	<u>\$ (28)</u>	<u>\$ 453</u>	<u>\$ (245)</u>	<u>\$ 13,858</u>

December 31, 2020

(In thousands)

	12 months or less		Greater than 12 months		Total	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
Investment grade:						
U.S. Treasury and government agencies	\$ (11)	\$ 973	\$ -	\$ -	\$ (11)	\$ 973
Total fixed maturities	<u>\$ (11)</u>	<u>\$ 973</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (11)</u>	<u>\$ 973</u>

The Company views the gross unrealized losses on fixed maturities as non-credit related and through its assessment of unrealized losses has determined that these securities will recover, allowing the Company to realize the anticipated long-term economic value. The Company currently does not intend to sell, nor does it expect to be required to sell these securities before recovery of their amortized cost. The Company employs a

The Hanover Atlantic Insurance Company Ltd.
Notes to Financial Statements

systematic methodology to evaluate declines in fair value below a amortized cost for fixed maturity securities. In determining impairments, the Company evaluates several factors and circumstances, including the issuer's overall financial condition; the issuer's credit and financial strength ratings; the issuer's financial performance, including earnings trends and asset quality; any specific events which may influence the operations of the issuer; the general outlook for market conditions in the industry or geographic region in which the issuer operates; and the degree to which the fair value of an issuer's securities is below the Company's amortized cost. The Company also considers any factors that might raise doubt about the issuer's ability to make contractual payments as they come due and whether the Company expects to recover the entire amortized basis of the security.

At December 31, 2021 and 2020, the Company had no investment exposure to any credit risk concentration of a single investee that exceeded 10% of stockholder's equity.

At December 31, 2021, there were no contractual investment commitments.

The components of net investment income were as follows:

For the Years Ended December 31, (In thousands)	2021	2020
Fixed maturities	\$ 1,242	\$ 1,280
Short-term income	-	7
Gross investment income	1,242	1,287
Less investment expense	(64)	(55)
Net investment income	<u>\$ 1,178</u>	<u>\$ 1,232</u>

The Company held no fixed maturities on non-accrual status at December 31, 2021 and 2020.

For the years ended December 31, 2021 and 2020, realized gains on fixed maturities were \$20 and \$174, respectively. There were no impairments at December 31, 2021. Included in net realized investment gains for the year ended December 31, 2020, were impairments of \$12.

For the year ended December 31, 2021, proceeds from sales of available-for-sale fixed maturities were \$62 and there were no associated gross realized gains or losses. For the year ended December 31, 2020, proceeds from sales of available-for-sale fixed maturities were \$672 and associated gross realized gains were \$7.

(4) Other Comprehensive Income Reconciliation

The following tables provide a reconciliation of unrealized gains and losses on available-for-sale fixed maturities as shown in the Statements of Comprehensive Income.

For the year ended December 31, 2021 (In thousands)	Pre-Tax	Tax Benefit	Net
Unrealized losses on a available-for-sale fixed maturity securities:			
Unrealized losses arising during period	\$ (1,705)	\$ 358	\$ (1,347)
Less: amount reclassified as realized investment gains	(20)	4	(16)
Other comprehensive loss	<u>\$ (1,725)</u>	<u>\$ 362</u>	<u>\$ (1,363)</u>

The Hanover Atlantic Insurance Company Ltd.
Notes to Financial Statements

For the year ended December 31, 2020

(In thousands)

	Pre-Tax	Tax (Expense) Benefit	Net
Unrealized gains on a available-for-sale fixed maturity securities:			
Unrealized gains arising during period	\$ 2,068	\$ (435)	\$ 1,633
Less: a amount reclassified as realized investment gains	(174)	37	(137)
Other comprehensive income	<u>\$ 1,894</u>	<u>\$ (398)</u>	<u>\$ 1,496</u>

(5) Fair Value

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability, i.e., exit price, in an orderly transaction between market participants. The Company emphasizes the use of observable market data whenever available in determining fair value. Fair values presented for certain financial instruments are estimates which, in many cases, may differ significantly from the amounts that could be realized upon immediate liquidation. A hierarchy of the three broad levels of fair value is as follows, with the highest priority given to Level 1 as these are the most observable, and the lowest priority given to Level 3:

Level 1 – Unadjusted quoted prices in active markets for identical assets or liabilities.

Level 2 – Quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, or other inputs that are observable or can be corroborated by observable market data, including model-derived valuations.

Level 3 – Unobservable inputs that are supported by little or no market activity.

When more than one level of input is used to determine fair value, the financial instrument is classified as Level 2 or 3 according to the lowest level input that has a significant impact on the fair value measurement.

The following methods and assumptions were used to estimate the fair value of each class of financial instruments and have not changed since last year.

Fixed Maturities

Level 1 securities generally include U.S. Treasury issues and other securities that are highly liquid and for which quoted market prices are available. Level 2 securities are valued using pricing for similar securities and pricing models that incorporate observable inputs including, but not limited to yield curves and issuer spreads. Level 3 securities include issues for which little observable data can be obtained, primarily due to the illiquid nature of the securities, and for which significant inputs used to determine fair value are based on the Company's own assumptions.

The Company utilizes a third party pricing service for the valuation of its fixed maturity securities and receives one quote per security. When quoted market prices in an active market are available, they are provided by the

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pricing service as the fair value and such values are classified as Level 1. Since fixed maturities other than U.S. Treasury securities generally do not trade on a daily basis, the pricing service prepares estimates of fair value for those securities using pricing techniques based on a market approach. Inputs into the fair value pricing common to all asset classes include: benchmark U.S. Treasury security yield curves; reported trades of identical or similar fixed maturity securities; broker/dealer quotes of identical or similar fixed maturity securities and structural characteristics such as maturity date, coupon, mandatory principal payment dates, frequency of interest and principal payments, and optional redemption features. Inputs into the fair value applications that are unique by asset class include, but are not limited to:

U.S. government agencies – determination of direct versus indirect government support and whether any contingencies exist with respect to the timely payment of principal and interest.

Municipals – overall credit quality, including assessments of the level and variability of: sources of payment such as income, sales or property taxes, levies or user fees; credit support such as insurance; state or local economic and political base; natural resource availability; and susceptibility to natural or man-made catastrophic events such as hurricanes, earthquakes or acts of terrorism.

Corporate fixed maturities – overall credit quality, including assessments of the level and variability of: economic sensitivity; liquidity; corporate financial policies; management quality; regulatory environment; competitive position; ownership; restrictive covenants; and security or collateral.

Residential mortgage-backed securities – estimates of prepayment speeds based upon: historical prepayment rate trends; underlying collateral interest rates; geographic concentration; vintage year; borrower credit quality characteristics; interest rate and yield curve forecasts; government or monetary authority support programs; tax policies; and delinquency/default trends.

Commercial mortgage-backed securities – overall credit quality, including assessments of the value and supply/demand characteristics of: collateral type such as office, retail, residential, lodging, or other; geographic concentration by region, state, metropolitan statistical area and locale; vintage year; historical collateral performance including defeasance, delinquency, default and special servicer trends; and capital structure support features.

Asset-backed securities – overall credit quality, including assessments of the underlying collateral type such as credit card receivables, automobile loan receivables and equipment lease receivables; geographic diversification; vintage year; historical collateral performance including delinquency, default and casualty trends; economic conditions influencing use rates and resale values; and contract structural support features.

Generally, all prices provided by the pricing service, except actively traded securities with quoted market prices, are reported as Level 2.

The estimated fair values of the financial instruments were as follows:

December 31, (In thousands)	2021		2020	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Financial assets carried at:				
<i>Cost:</i>				
Cash and cash equivalents	\$ 837	\$ 837	\$ 964	\$ 964
<i>Fair Value through AOCI:</i>				
Fixed maturities	49,341	49,341	50,008	50,008
Total financial instruments	\$ 50,178	\$ 50,178	\$ 50,972	\$ 50,972

The Company had no financial liabilities measured at fair value at December 31, 2021 or 2020.

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The Company has processes designed to ensure that the values received from its third party pricing service are accurately recorded, that the data inputs and valuation approaches and techniques utilized are appropriate and consistently applied, and that the assumptions are reasonable and consistent with the objective of determining fair value. The Company reviews the pricing service's policies describing its methodology, processes, practices and inputs, including various financial models used to value securities. For assets carried at fair value, the Company performs a review of the fair value hierarchy classifications and of prices received from its pricing service on a quarterly basis. Also, the Company reviews the portfolio pricing, including a process for which securities with changes in prices that exceed a defined threshold are verified to independent sources, if available. If upon review, the Company is not satisfied with the validity of a given price, a pricing challenge would be submitted to the pricing service along with supporting documentation for its review. The Company does not adjust quotes or prices obtained from the pricing service unless the pricing service agrees with the Company's challenge. During 2021 and 2020, the Company did not adjust any prices received from its pricing service.

Changes in the observability of valuation inputs may result in a reclassification of certain financial assets within the fair value hierarchy. As previously discussed, the Company utilizes a third party pricing service for the valuation of all of its fixed maturities. The pricing service has indicated that it will only produce an estimate of fair value if there is objectively verifiable information to produce a valuation. If the pricing service discontinues pricing an investment, the Company will use observable market data to the extent it is available, but may also be required to make assumptions for market based inputs that are unavailable due to market conditions.

The following tables provide, for each hierarchy level, the Company's assets that were carried at fair value on a recurring basis.

December 31, 2021		Fair Value			
(In thousands)		Total	Level 1	Level 2	Level 3
U.S. Treasury and government agencies	\$	3,148	\$ 2,663	\$ 485	\$ -
Municipal		26,662	-	26,662	-
Corporate		14,192	-	14,192	-
Residential mortgage-backed		3,071	-	3,071	-
Commercial mortgage-backed		1,706	-	1,706	-
Asset-backed		562	-	562	-
Total fixed maturities	\$	<u>49,341</u>	<u>\$ 2,663</u>	<u>\$ 46,678</u>	<u>\$ -</u>

December 31, 2020		Fair Value			
(In thousands)		Total	Level 1	Level 2	Level 3
U.S. Treasury and government agencies	\$	4,140	\$ 3,127	\$ 1,013	\$ -
Municipal		21,301	-	21,301	-
Corporate		16,374	-	16,374	-
Residential mortgage-backed		5,474	-	5,474	-
Commercial mortgage-backed		1,940	-	1,940	-
Asset-backed		779	-	779	-
Total fixed maturities	\$	<u>50,008</u>	<u>\$ 3,127</u>	<u>\$ 46,881</u>	<u>\$ -</u>

There were no Level 3 assets or liabilities held by the Company during the years ended December 31, 2021 or 2020.

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(6) Outstanding Claims, Losses and Loss Adjustment Expenses

The Company regularly updates its reserve estimates as new information becomes available and further events occur which may impact the resolution of unsettled claims. Reserve adjustments are reflected in results of operations as adjustments to losses and LAE net of reinsurance. Given that the Company's losses and LAE are ceded 100% to Hanover, both the incurred and paid losses and LAE, net of reinsurance, are zero.

The following table provides a reconciliation of the gross beginning and ending reserve for unpaid losses and LAE for the year ended December 31, 2021 and 2020.

(In thousands)	2021	2020
Gross reserve for losses and LAE, beginning of period	\$ 8,661	\$ 2,053
Change in reinsurance recoverable on unpaid losses	12,006	6,608
Gross reserve for losses and LAE, end of period	\$ 20,667	\$ 8,661

(7) Statutory Requirements (RBC)

The Company is licensed as a Class 3A insurer under the Act, which requires insurance companies to meet and maintain certain minimum levels of solvency and liquidity. Each year, the Company is required to file with the Bermuda Monetary Authority (the "Authority") a Capital and Solvency Return, Statutory Financial Return (SFR) and Audited Financial Statements within four months of its relevant financial year end.

In accordance with the Act, the minimum solvency margin required at December 31, 2021 was \$1,000 and the actual statutory capital and surplus was \$50,249. The Company therefore met the minimum solvency margin at December 31, 2021. In addition, a minimum liquidity ratio must be maintained whereby the value of relevant assets is not less than 75% of relevant liabilities. At December 31, 2021, the Company was required to maintain relevant assets of approximately \$16,797. At that date, relevant assets were approximately \$72,903 and the minimum liquidity ratio was therefore met.

The Company is prohibited from declaring or paying a dividend if its Class 3A statutory capital and surplus is less than its Enhanced Capital Requirement ("ECR"), or if it is in breach of its solvency margin or minimum liquidity ratio, or if the declaration or payment of such dividend would cause such breach. Further, the Company is prohibited from paying in any year dividends of more than 25% of its statutory capital and surplus unless it files (at least seven days before payment of such dividends) with the Authority an affidavit stating that it will continue to meet its solvency margin and minimum liquidity ratio. The maximum amount available for payment of dividends without regulatory approval is \$12,667.

(8) Income Taxes

Provisions for federal income taxes have been calculated in accordance with the provisions of ASC 740. A summary of the federal income tax expense in the Statement of Income for the year ended December 31, 2021 and 2020 is shown below (in thousands):

	2021	2020
Current federal tax expense	\$ 244	\$ 239
Deferred federal tax expense	8	56
Total income tax expense	\$ 252	\$ 295
Effective tax rate	21%	21%

The Company's deferred tax assets and liabilities are attributable to depreciation and appreciation in the investment portfolios and are reduced by a valuation allowance if it is more likely than not that all or some

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portion of the deferred tax assets will not be realized. The Company believes it is more likely than not that the deferred tax assets and liabilities will be realized.

As of December 31, 2021 and 2020, the Company had no unrecognized tax benefits. The Company files income tax returns in the U.S. federal jurisdiction, and tax years after 2018 are subject to U.S. federal income tax examinations.

(9) Related-Party Transactions

Pursuant to an intercompany consolidated service agreement, legal entities are charged the cost of the service provided or expenses paid by the entity providing the service or paying the expense. In addition, affiliated entities are charged a portion of the costs associated with activities that are performed for the good of all THG companies. Investment-related services are provided by Opus pursuant to an intercompany advisory agreement. The Company expensed \$64 and \$55 associated with the advisory agreement for the year ended December 31, 2021 and 2020, respectively. All insurance company expenses are subsequently ceded to Hanover pursuant to the 100% intercompany reinsurance agreement. At December 31, 2021 and 2020 the reinsurance payable was \$22,388 and \$7,855, respectively. There were related party payables of \$5 included in accounts payable and accrued expenses at December 31, 2021 and 2020. The terms of the intercompany management and service arrangements require that intercompany balances be settled within thirty days.

The Company declared an ordinary dividend to Hanover on December 11, 2020 totaling \$3,000 which was settled with bonds at fair value of \$2,933, accrued interest of \$28 and cash of \$39.

(10) Employee Benefit Plans

Hanover provides multiple benefit plans to employees, agents and retirees of the Company, including retirement plans and postretirement medical and death benefit plans. The salaries of employees and agents covered by these plans and the expenses of these plans are charged to the Company in accordance with an inter-company cost sharing agreement. Any benefit expenses related to the Company were subsequently ceded to Hanover pursuant to the 100% intercompany reinsurance agreements.

(11) Subsequent Events

The Company evaluated transactions through April 22, 2022 and found no subsequent events requiring adjustments to the financial statements.