

REPORT ON EXAMINATION AS TO THE CONDITION OF

WATFORD SPECIALTY INSURANCE COMPANY

MORRISTOWN, NEW JERSEY

AS OF DECEMBER 31, 2019

NAIC GROUP CODE 4871

NAIC COMPANY CODE 15824

FILED
JUNE 24, 2021
COMMISSIONER
DEPARTMENT
OF
BANKING AND INSURANCE

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DEPARTMENT OF BANKING AND INSURANCE
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May 27, 2021

Honorable Marlene Caride
Commissioner of Banking and Insurance
State of New Jersey
20 West State Street
Trenton, New Jersey 08625

Commissioner:

Pursuant to the Revised Statutes of the State of New Jersey, an examination has been made of the conditions and affairs of the assets and liabilities, method of conducting business and other affairs of the:

WATFORD SPECIALTY INSURANCE COMPANY
MORRISTOWN, NJ 07962
NAIC GROUP CODE 4871
NAIC COMPANY CODE 15824

a domestic insurer duly authorized to transact the business of insurance in the State of New Jersey. Hereinafter, Watford Specialty Insurance Company will be referred to in this report as the "Company", or "WSIC".

SCOPE OF EXAMINATION

This risk-focused examination was called by the Commissioner of Banking and Insurance of the State of New Jersey pursuant to the authority granted by N.J.S.A. Section 26:2J-18.1 of the New Jersey Revised Statutes. This examination was conducted concurrently with the examination of the Company's subsidiary Watford Insurance Company ("WIC").

The examination was made as of December 31, 2019 and addressed the four-year period from January 1, 2016 to December 31, 2019. During this period, the Company's reported admitted assets increased by \$21,212,990 to \$91,145,847 from \$69,932,857, liabilities increased by \$26,557,958 to \$31,382,877 from \$4,824,919 and total capital and surplus decreased by \$5,344,969 to \$59,762,969 from \$65,107,938.

The New Jersey Department of Banking and Insurance ("NJDOBI") conducted the examination in accordance with the 2020 edition of the National Association of Insurance Commissioners ("NAIC") Financial Condition Examiners Handbook (the "NAIC Handbook"). The NAIC Handbook requires NJDOBI to plan and perform the examination in order to evaluate the financial condition and identify prospective risks of the Company. To meet these objectives, NJDOBI obtained information regarding the Company's corporate governance environment, identified and assessed inherent risks to which it is exposed and evaluated the Company's system of internal controls and procedures used to mitigate identified risks. The examination also included assessing the principles used and significant estimates made by management, as well as evaluating the overall Financial Statement presentation, management's compliance with Statutory Accounting Principles and Annual Statement instructions when applicable to domestic state regulations.

All accounts and activities of the Company were considered in accordance with the risk-focused examination process. The examination report only addresses regulatory information revealed by the examination process in accordance with the NAIC Handbook. All other financial matters were reviewed and determined not to be material for discussion in this report.

COMPLIANCE WITH PRIOR REPORT ON EXAMINATION RECOMMENDATIONS

This is the Company's first report on examination since receiving its New Jersey Certificate of Authority on September 30, 2015. As such, there were no prior comments and recommendations needing review during this examination.

HISTORY

The Company is a New Jersey domestic stock property and casualty insurance company designated as a "domestic surplus lines insurer" pursuant to N.J.S.A. 17:22-6.69b. The Company's principal business is to insure property, casualty and specialty risks throughout the United States on an excess and surplus lines basis. WSIC is a direct, wholly-owned subsidiary of Watford Holdings (U.S.) Inc., which is in turn a direct, wholly-owned subsidiary of Watford Holdings (U.K.) Limited, itself a direct, wholly-owned subsidiary of Watford Re Ltd. ("Watford Re"). Watford Re is a "Class 4" Bermuda insurance company. Watford Re is a direct, wholly-owned subsidiary of Watford Holdings Ltd., a Bermuda-exempted company with limited liability. Watford Holdings

Ltd. has been designated as the ultimate controlling person (“UCP”) with respect to WSIC for purposes of ongoing reporting applicable to UCPs.

On July 13, 2015 pursuant to N.J.S.A. 11:1-28.5 a feasibility study was presented to the NJDOBI to propose formation of a property and casualty surplus lines insurer to provide coverage throughout the United States on an excess and surplus lines basis. A Certificate of Incorporation (“COI”) dated August 21, 2015 was filed with the NJDOBI and was approved by the Acting Commissioner on September 17, 2015. The COI was recorded by the Morris County Clerk as filed by the NJDOBI on September 8, 2015. WSIC received its New Jersey Certificate of Authority on September 30, 2015.

Under the Fourth and Fifth Articles of its COI, WSIC is organized as a stock company and is authorized to issue capital stock of \$10,000,000 divided into 100,000 shares of common stock having a par value of \$100 per share. At December 31, 2019, there were 42,000 shares of common stock issued and outstanding, with all shares held by parent Watford Holdings (U.S.) Inc. On September 24, 2015, the Company received an additional capital contribution of \$55,800,000 from its parent. The Company received an additional capital contribution of \$7,650,000 from its parent during 2016. There were no dividends paid to the Company’s stockholder during the examination period.

The Company purchased WIC on August 1, 2016 from Hanover Insurance Company. WIC is a New Jersey domiciled property and casualty insurance company that holds admitted insurance licenses in all 50 states and the District of Columbia. The Company carries the investment in this subsidiary at statutory surplus in accordance with SSAP No. 97. Changes in unrealized gains and losses on this investment are reported directly in the Company’s unassigned surplus and do not affect income.

WSIC’s statutory home office is located at 445 South Street, Suite 220 P.O. Box 1988, Morristown, NJ 07962. Operational activities for WSIC are completed primarily at 210 Hudson Street, Suite 300, Jersey City, NJ 07311.

STATUTORY DEPOSIT

As of December 31, 2019, the Company, in accordance with N.J.S.A. 17B:18-37(c), had a fair market value of \$114,942 for the New Jersey statutory deposit.

TERRITORY AND PLAN OF OPERATION

WSIC is domiciled in the State of New Jersey and has a Certificate of Authority to operate as a surplus lines writer in the State of New Jersey for the purpose of providing the kinds of insurance authorized by paragraphs (a), (b), (e), (f), (g), (i), (j), (k), (l), (m), (n) and various miscellaneous coverages under section (o) of N.J.S.A. 17:17-1, ‘Health Insurance’ as defined in N.J.S.A. 17B:17-4, and ‘Municipal Bond Insurance’ as defined in N.J.A.C. 11:7. WSIC also holds certificates of authority and/or is allowed to write surplus line business either through its license in New Jersey or through licensed surplus lines brokers in all other states and the District of Columbia.

WSIC generated its 2019 direct business through managing general underwriters (“MGUs”) on a program basis and through a coinsurance arrangement with Arch Specialty Insurance Company (“ASIC”). The Company’s program business was primarily written through the following MGUs during 2019:

- First Indemnity Insurance Agency Inc. - Law firm errors and omissions excess liability
- Breckenridge Insurance Services LLC - Fire suppression and roofing contractors general liability
- Safehold Special Risk, Inc. - Forestry and wood products property liability
- Entertainment Risk, LLC - Entertainment venue general liability and liquor liability
- W.E. Love and Associates, LLC - Trucking business specialty casualty
- International Property & Casualty Insurance Brokers of Nevada, Inc. (IPC) - Food delivery hired and non-owned automobile liability

The coinsurance business is written with ASIC through a series of service agreements and a Surplus Lines Binding Authority Agreement, effective January 1, 2019, with its affiliates. The coinsurance business includes primary general liability and automobile, umbrella and excess liability, property marine and energy, directors and officers liability, professional liability and medical malpractice.

WSIC delegates its claims processing to licensed third party claims-handling firms per terms of written service agreements. Following are the claims service providers utilized during 2019:

- NAS Insurance Services, LLC
- Triton Claim Management, LLC
- North American Risk Services, Inc.
- Gallagher Bassett Services, Inc.
- York Risk Services Group, Inc.

In 2020, the Company also began utilizing ESIS as a claims service provider.

The Company does not have any direct employees. Operational and administrative services for WSIC are completed per terms of written agreements as outlined below at the “Intercompany Agreements / Related Party Transactions” section of this report.

Marketing and advertising is targeted and limited primarily to program administrators and brokers through trade shows, conferences and related events.

REINSURANCE

At December 31, 2019, the Company had the following reinsurance in effect with unaffiliated reinsurers:

Cyber Liability

100% Quota Share

Reinsurers: Lloyd's Syndicates 510, 4141, 1880
Business Covered: Cyber liability endorsements
Policy Limit: \$5 million
Treaty Retention: 0% as Company cedes 100% of gross liability
Treaty Limit: None

Property Liability

Facultative Excess of Loss

Reinsurers: Munich Reinsurance America, Inc., Swiss Reinsurance America Corporation, Hannover Re
Business Covered: Forestry and wood products business
Policy Limit: \$20 million
Treaty Retention Layer 1: \$1 million
Treaty Retention Layer 2: \$10 million
Treaty Limit Layer 1: \$9 million each risk and \$18 million per occurrence 77.5% placement
Treaty Limit Layer 2: \$10 million each loss and \$20 million per occurrence 100% placement

Follow Form Excess Liability

60% Quota Share

Reinsurer: Everest Reinsurance Company
Business Covered: Fire suppression and roofing contractors
Policy Limit: \$5 million per occurrence
Treaty Retention: \$2 million per occurrence
Treaty Limit: \$3 million per occurrence

Net Retained Liability Quota Share

Quota Share - Varying Percentages

Reinsurer: Arch Reinsurance Company
Business Covered: Individual underwriting programs
Policy Limit: N/A
Treaty Retention: The reinsurer assumes a 15% to 90% quota share for each program
Treaty Limit: N/A

At December 31, 2019, the Company had the following reinsurance in effect with an affiliated reinsurer:

Net Retained Liability Quota Share

85% Quota Share

Reinsurer: Watford Re Ltd.
Business Covered: All business net of other ceded reinsurance
Policy Limit: N/A
Treaty Retention: 15% quota share
Treaty Limit: N/A

CORPORATE RECORDS

A review of the minutes of the Board of Directors (or “Board”) meetings noted that all meetings were well attended. The Board minutes also indicated that the Company’s overall transactions and events were adequately supported and approved.

MANAGEMENT AND CONTROL

The business, property and affairs of the Company are managed by a single President/Chief Executive Officer and delegated officers under the guidance and direction of the Board of Directors. In accordance with the bylaws, the Board of Directors shall consist of not less than five or more than fifteen members. The following directors were elected and serving at the examination date:

Directors

<u>Name</u>	<u>Principal Occupation</u>
Alexandre Jean Marie Scherer	President & CEO of the Company
Christiane Fischer Harling	Independent Director - Self Employed
Walter Leo Harris	Independent Director and Chairman of Watford Holdings Ltd. and Watford Re
	President and CEO of FOJP Service Corporation and Hospitals Insurance Company
Kenneth James Vivian	President & CEO of Arch Re North America
John Fredrick Rathgeber	Former CEO of Watford Re

The Company is required to comply with the provisions of N.J.S.A. 17:27A-4d(3), which states that “not less than one-third of the directors of a domestic insurer shall be persons who are not officers or employees of that insurer or of any entity controlling, controlled by, or under common control with, that insurer and who are not beneficial owners of a controlling interest in the voting securities of that insurer or any such entity.”

The Company was determined to be in compliance with the provisions of N.J.S.A. 17:27A-4(d)(3) as of the examination date, as the Board consists of five members, of which two are considered outside directors. In 2020, Brian Dann First and Jonathan David Levy replaced Kenneth Vivian and John Rathgeber as directors.

Committees

The WSIC Board does not have its own committees. The Watford Holdings Ltd. Board and its committees act on behalf of the Company. Those committees include an Audit Committee, Compensation Committee, Nominating and Governance Committee, Investment Committee, Risk Committee, Strategy Committee, and Underwriting Committee.

The Company is required to comply with the provisions of N.J.S.A. 17:27A-4d(4), which states that “the board of directors of a domestic insurer shall establish one or more committees comprised solely of directors who are not officers or employees of the insurer or of any entity controlling, controlled by, or under common control with, the insurer and who are not beneficial owners of a controlling interest in the voting securities of the insurer of any such entity. The committee shall be responsible for recommending the selection of independent certified public accountants, reviewing the insurer’s financial condition, the scope and results of the independent audit and any

internal audit, nominating candidates for director for election by shareholders or policyholders, evaluating the performance of officers deemed to be principal officers of the insurer and recommending to the board of directors the selection and compensation, including bonuses or other special payments, of the principal officers.”

The Company was determined to be in compliance with the provisions of N.J.S.A. 17:27A-4(d)(4) as of the examination date, as the Audit Committee is comprised solely of independent, outside directors who performed the functions indicated in this statute.

Officers

The officers of the Company perform duties as designated by the Company’s bylaws with respect to the offices they hold, or as otherwise indicated by the Board. The Chief Executive Officer, President, Treasurer, and Secretary shall be elected by majority vote of the Board. Other officers, if any, may be elected by the Board. Any two or more offices may be held by the same person apart from President and Secretary. Any officer may be required by the directors to give bond for the faithful performance of their duties to the corporation in such amount and with such sureties as the directors may determine.

The following officers were elected and serving the Company at December 31, 2019:

<u>Name</u>	<u>Title</u>
Alexandre Jean Marie Scherer	President & CEO of the Company
Barry Eric Golub	CFO & Treasurer
Anna DeChristofano	Corporate Secretary

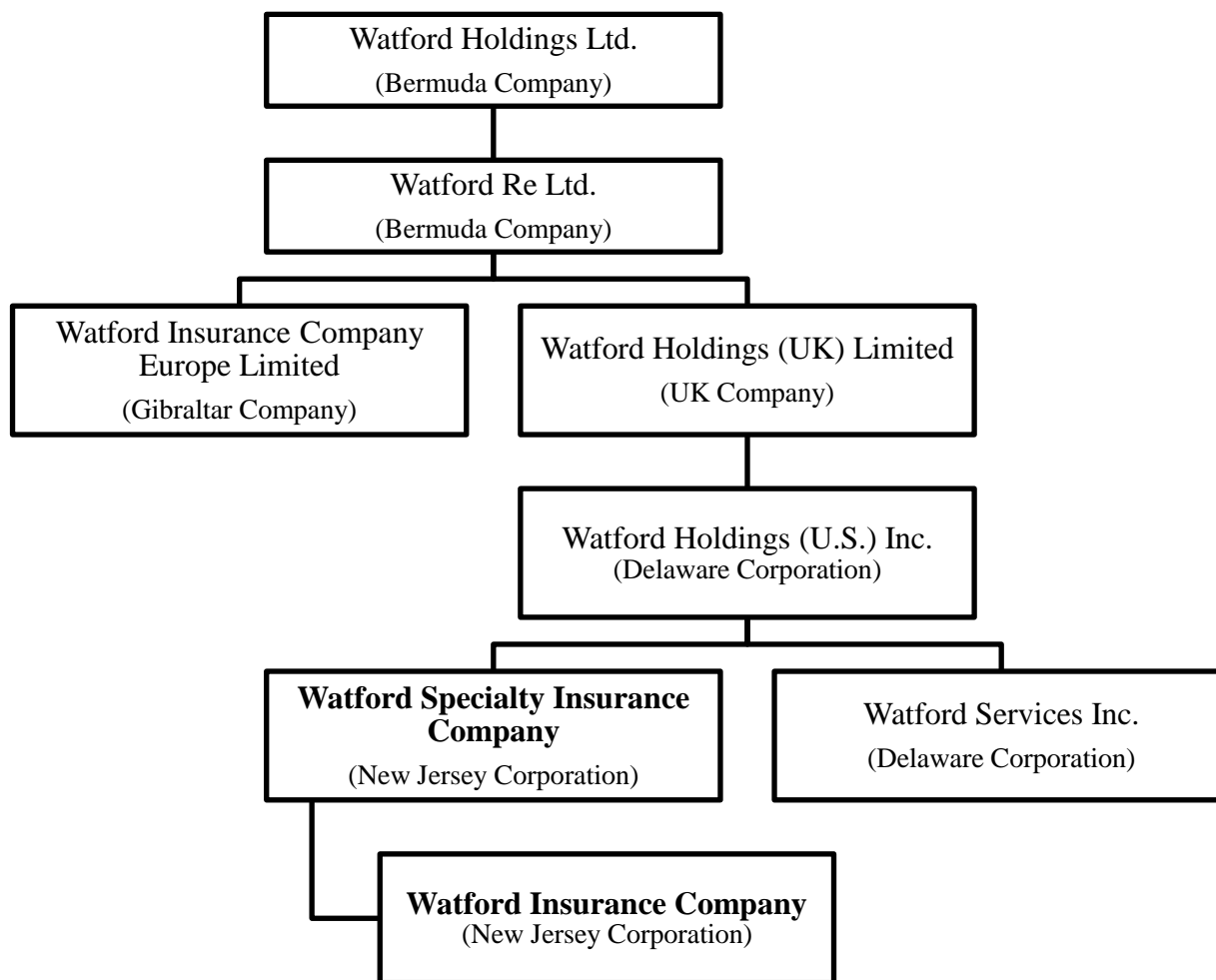
In 2020, Barry Eric Golub was replaced by Thomas James Ahern as Chief Financial Officer and Treasurer. In 2021, Anna DeChristofano was replaced by Regan Shulman as Corporate Secretary. N.J.S.A. 17:27A-4d(5) states, “The provisions of paragraphs (3) and (4) of this subsection d. shall not apply to a domestic insurer if the person controlling the insurer is an entity having a board of directors and committees thereof that substantially meet the requirements of those paragraphs.”

The Company satisfies the requirements of N.J.S.A. 17:27A-4d(5).

REGULATION OF INSURANCE HOLDING COMPANY SYSTEMS

The Company is a member of an insurance holding company system as defined in N.J.S.A. 17:27A-1 and is subject to the registration requirements of N.J.S.A. 17:27A-3.

A holding company system organizational chart as of December 31, 2019 follows:



INTERCOMPANY AGREEMENTS / RELATED PARTY TRANSACTIONS

Intercompany Agreements

The Company was a named party to the following affiliated agreements at the examination date:

Tax Sharing Agreement

Effective October 1, 2015 and as amended September 15, 2017, WSIC entered into a tax sharing agreement with Watford Holdings (U.S.) Inc. and affiliate Watford Services Inc. (“WSI”), for all taxable periods ending after December 31, 2014. Under this agreement, U.S. federal income tax expense is computed as if each company within the group filed a separate tax return. Intercompany tax balances are to be settled no later than three days prior to the date the parent is required to make a tax payment. WIC was added to this agreement effective August 1, 2016.

Employee Leasing Agreement

Effective October 1, 2015, WSIC entered into an Employee Leasing Agreement with WSI, whereby WSI shall furnish designated employees to provide such services as are usual and customary for WSIC’s operation as an insurance company. Designated employees are compensated and obtain benefits in accordance with terms of an employment agreement.

Investment Manager Agreement

Effective February 1, 2016, WSIC entered into an investment manager agreement with Arch Investment Management Ltd. (“AIM”) whereby AIM provides investment management services. AIM’s service levels requirements, reporting responsibilities and investment guidelines are established within this agreement.

Reimbursement Agreement

Effective July 1, 2016, WSIC entered into a Reimbursement Agreement with Watford Holdings (U.K.) Limited and its affiliates whereby WSIC shall reimburse Watford Holdings any fees or expenses paid for the primary benefit of WSIC, including fees and expenses of counsel, third party service providers and registration fees.

Commitment Agreement

Effective October 15, 2015, WSIC entered into an agreement with Watford Holdings (U.S.) Inc. whereby Watford Holdings (U.S.) Inc. commits that if surplus as regards to policyholders as reported on WSIC’s quarterly or annual statements filed with the NJDOBI falls below \$50 million for two consecutive calendar quarters, Watford Holdings (U.S.) Inc. shall contribute capital and surplus to enable WSIC to maintain policyholders’ surplus equal to at least \$50 million.

Services Agreement

Effective October 1, 2015 and as amended October 1, 2016 and January 1, 2019, WSIC entered into a Services Agreement with Arch Underwriters Inc. (“AUI”). Under this agreement, AUI formulates the Company’s overall portfolio of insurance and has full discretion in soliciting, negotiating, supervising the underwriting of and administering, but not binding, contracts providing insurance coverage by WSIC. The agreement is subject to the terms and conditions of a Business Framework and separate Underwriting Guidelines established within this agreement.

Surplus Lines Binding Authority Agreement

Effective January 1, 2019, WSIC entered into a Surplus Lines Binding Authority Agreement with Arch Specialty Insurance Agency, Inc. (“ASIA”). Under this agreement, ASIA has excess and surplus lines binding authority on behalf of WSIC for certain lines of business within the State of California, subject to specified lines of business and underwriting guidelines specified within this agreement.

Guarantee Agreement

Effective January 1, 2017, WSIC entered into a Guarantee Agreement with Arch Capital Group (U.S.) Inc. (“Arch Capital”). Under this agreement, Arch Capital guarantees the full and punctual performance by AUI of its obligations under the Services Agreement with WSIC.

Quota Share Reinsurance Agreements

Effective January 1, 2016, WSIC entered into a varying percentage Quota Share Reinsurance Agreement with Arch Reinsurance Company. Effective January 1, 2016, WSIC entered into an 85% Quota Share Reinsurance Agreement with Watford Re. See the “Reinsurance” section of this report for additional details.

Related Party Transactions

On September 24, 2015, the Company received an initial capital contribution of \$60,000,000 from its parent Watford Holdings (U.S.) Inc. in the form of common capital stock of \$4,200,000 and paid in capital of \$55,800,000.

In July 2016, The Company received a paid in capital contribution of \$7,650,000 from its parent Watford Holdings (U.S.) Inc.

The Company purchased WIC on August 1, 2016 from Hanover Insurance Company, acquiring its licenses and surplus for \$19,400,000.

In September 2016, WSIC made a capital contribution to WIC in the amount of \$8,500,000.

In June 2017, WSIC made a capital contribution to WIC in the amount of \$250,000.

In February 2019, WSIC made a capital contribution to WIC in the amount of \$9,000,000.

In September 2019, WSIC made a capital contribution to WIC in the amount of \$5,000,000.

POLICY ON CONFLICT OF INTEREST

On an annual basis, the Company's Officers attest to an affirmation of ethical standards and a disclosure of possible activities which could construe as a conflict of interest. Beginning in 2021, the Company's directors attest annually to an affirmation of ethical standards and a disclosure of possible activities which could construe as a conflict of interest. Prior to 2021, the directors informally reviewed the policy.

A review of the ethical attestations and conflictual disclosures for officers and directors revealed no exceptions.

INFORMATION SYSTEMS

Information systems were reviewed at the service company level. The IT examination team's procedures considered a customized range of IT risks contained within the NAIC Exhibit C Part 2 Work Program, focusing on both IT governance and IT operational controls. Overall, the IT examination team concluded that IT General Controls (ITGCs) are effective. IT review conclusions were based on inquiry, inspection of documentation, observation, independent research and a review of third-party workpapers. The IT examination team's conclusion regarding control strength was discussed with, and accepted by, the Examiner-in-Charge at the conclusion of the IT review.

CONTINUITY OF OPERATIONS

The Company's bylaws provide for the election of directors and the appointment of officers to fill any vacancies caused by death, resignation, disqualification, or removal by the Board of Directors.

The Company has a disaster recovery plan that was reviewed in the course of the examination IT review. No material findings were noted.

FINANCIAL STATEMENT EXHIBITS

<u>Exhibit A:</u>	Statement of Assets, Liabilities, Surplus and Other Funds at December 31, 2019	12
<u>Exhibit B:</u>	Summary of Revenue and Expenses for the Five-Year Period ending December 31, 2019	13
<u>Exhibit C:</u>	Capital and Surplus Account for the Five-Year Period ending December 31, 2019	14

Exhibit A

Statement of Assets, Liabilities, Surplus and Other Funds at December 31, 2019

	Current Examination at 12/31/2019	Balance Per Company at 12/31/2019	Examination Change	Note Number
<u>Assets</u>				
Invested Assets:				1
Bonds	\$33,403,442	\$33,403,442	\$0	
Common Stock - WIC	34,940,330	34,940,330	0	
Cash, Cash Equivalents and Short-Term Investments	10,918,232	10,918,232	0	
Receivables for Securities	7,361	7,361	0	
Investment Income Due and Accrued	197,641	197,641	0	
Premiums and Considerations:				
Uncollected premiums and agents' balances in the course of collection	632,416	632,416		
Deferred premiums and agents' balances and installments booked but deferred and not yet due	4,405,176	4,405,176		
Amounts Recoverable from Reinsurers	478,068	478,068	0	
Current Federal and Foreign Income Tax Recoverable and Interest Thereon		-	0	
Receivable from Parent, Subsidiaries and Affiliates	1,750,485	1,750,485	0	
Aggregate Write-ins for Other than Investment Assets	<u>4,412,696</u>	<u>4,412,696</u>	<u>0</u>	
Total Admitted Assets	<u>\$91,145,847</u>	<u>\$91,145,847</u>	<u>\$0</u>	
<u>Liabilities</u>				
Losses and Loss Adjustment Expenses	\$5,565,017	\$5,565,017	\$0	2
Commissions Payable, Contingent Commissions and Other Similar Charges	(1,081,110)	(1,081,110)	0	
Other Expenses	68,531	68,531	0	
Taxes, Licenses and Fees	172	172	0	
Current Federal and Foreign Income Taxes on Realized Capital Gains	1,359,122	1,359,122		
Unearned Premiums	4,072,255	4,072,255		
Ceded Reinsurance Premiums Payable	15,819,701	15,819,701	0	
Remittances and Items Not Allocated	489,375	489,375	0	
Aggregate Write-ins for Liabilities	<u>5,089,814</u>	<u>5,089,814</u>	<u>0</u>	
Total Liabilities	<u>\$31,382,877</u>	<u>\$31,382,877</u>	<u>\$0</u>	
<u>Surplus and Other Funds</u>				
Common Capital Stock	\$4,200,000	\$4,200,000	\$0	
Gross Paid In and Contributed Surplus	63,450,000	63,450,000	0	
Unassigned Funds (Surplus)	<u>(7,887,031)</u>	<u>(7,887,031)</u>	<u>0</u>	
Surplus as Regards Policyholders	<u>\$59,762,969</u>	<u>\$59,762,969</u>	<u>\$0</u>	3
Total Liabilities, Surplus and Other Funds	<u>\$91,145,847</u>	<u>\$91,145,847</u>	<u>\$0</u>	

Summary of Revenue and Expenses for the Five-Year Period Ending December 31, 2019

<u>UNDERWRITING INCOME</u>	<u>2019</u>	<u>2018</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>
Premiums Earned	\$5,262,228	\$2,825,639	\$1,199,048	\$246,664	\$0
Deductions:					
Losses Incurred	3,096,805	1,537,549	556,927	111,001	0
Loss Adjustment Expenses Incurred	801,940	456,116	151,692	33,075	0
Other Underwriting Expenses Incurred	<u>1,026,396</u>	<u>1,457,636</u>	<u>2,317,924</u>	<u>1,660,637</u>	<u>504,767</u>
Total Deductions	\$4,925,141	\$3,451,301	\$3,026,543	\$1,804,713	\$504,767
Net Underwriting Gain or (Loss)	<u>\$337,087</u>	<u>(\$625,662)</u>	<u>(\$1,827,495)</u>	<u>(\$1,558,049)</u>	<u>(\$504,767)</u>
 <u>INVESTMENT INCOME</u>					
Net Investment Income Earned	\$1,073,596	\$1,666,095	\$1,827,430	\$1,099,053	\$184
Net Realized Capital Gains or (-) Losses	<u>62,790</u>	<u>67,612</u>	<u>314,775</u>	<u>(20,893)</u>	<u>0</u>
Net Investment Gain	<u>\$1,136,386</u>	<u>\$1,733,707</u>	<u>\$2,142,205</u>	<u>\$1,078,160</u>	<u>\$184</u>
 <u>OTHER INCOME</u>					
Net Gain or Loss (-) From Agents' Balances Charged Off	\$0	\$0	\$0	\$0	\$0
Finance or Service Charge not Included in Premiums	0	0	0	0	0
Aggregate Write-ins for Miscellaneous Income	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
Total Other Income	<u>\$0</u>	<u>\$0</u>	<u>\$0</u>	<u>\$0</u>	<u>\$0</u>
Net Income Before Dividends to Policyholders and Before Federal and Foreign Income Taxes	\$1,473,473	\$1,108,045	\$314,710	(\$479,889)	(\$504,583)
Dividends to Policyholders	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
Net Income Before Federal Income Taxes	\$1,473,473	\$1,108,045	\$314,710	(\$479,889)	(\$504,583)
Federal and Foreign Income Taxes Incurred	<u>1,047,445</u>	<u>582,521</u>	<u>0</u>	<u>0</u>	<u>0</u>
Net Income	<u><u>\$426,028</u></u>	<u><u>\$525,524</u></u>	<u><u>\$314,710</u></u>	<u><u>(\$479,889)</u></u>	<u><u>(\$504,583)</u></u>

Capital and Surplus Account for the Five-Year Period Ending December 31, 2019

	<u>2019</u>	<u>2018</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>
Net Income	<u>\$426,028</u>	<u>\$525,524</u>	<u>\$314,710</u>	<u>(\$479,889)</u>	<u>(\$504,583)</u>
<u>OTHER SURPLUS GAINS OR (-) LOSSES</u>					
Change In Net Unrealized Capital Gains or (-) Losses	(1,492,475)	(4,481,535)	(1,529,958)	154,244	0
Change in Net Deferred Income Tax	0	0	(916,332)	916,332	0
Change in Non Admitted Assets	(134,747)	399,734	1,544,082	(2,628,166)	0
Paid in Capital	0	0	0	0	4,200,000
Paid in Surplus	0	0	0	7,650,000	55,800,000
Total Other Surplus Gains or (-) Losses	<u>(\$1,627,222)</u>	<u>(\$4,081,801)</u>	<u>(\$902,208)</u>	<u>\$6,092,410</u>	<u>\$60,000,000</u>
Increase or (-) Decrease as Regards Policyholders	(\$1,201,194)	(\$3,556,277)	(\$587,498)	\$5,612,521	\$59,495,417
Surplus as Regards Policyholders					
December 31, Previous Year	<u>\$60,964,163</u>	<u>\$64,520,440</u>	<u>\$65,107,938</u>	<u>\$59,495,417</u>	<u>\$0</u>
Surplus as Regards Policyholders					
December 31, Current Year	<u>\$59,762,969</u>	<u>\$60,964,163</u>	<u>\$64,520,440</u>	<u>\$65,107,938</u>	<u>\$59,495,417</u>

NOTES TO THE FINANCIAL STATEMENTS

Note 1 - Invested Assets

As of December 31, 2019, WSIC held 42.1% of its invested assets in bonds in the amount of \$33,403,442 and approximately 44.1% in stocks through its 100% ownership of WIC in the amount of \$34,940,330, and 13.8% in cash and short-term investments in the amount of \$10,918,232. The majority of the Company's bond holdings are investment grade with NAIC 1 (76.7%) and NAIC 2 (4.5%) ratings with NAIC 4 (16.8%) and NAIC 5 (2.0%) rated bonds also held at December 31, 2019. The Company's invested assets are in compliance with New Jersey laws and regulations and the SVO Purposes and Procedures Manual.

Note 2 - Losses and Loss Adjustment Expenses

The Company's reported liabilities at December 31, 2019, for losses and loss adjustment expenses, net of reinsurance, amounted to \$4,481,544 and \$1,083,473, respectively.

Jeffrey R. Carlson, FCAS, MAAA, of Willis Towers Watson, appointed by the Board of Directors, rendered an opinion that loss and loss adjustment expense reserves recorded as of December 31, 2019, made a reasonable provision for all unpaid loss and loss adjustment expenses of the Company under the terms of its contracts and agreements.

NJDOBI contracted with Risk & Regulatory Consulting, LLC to review the Company's loss and loss adjustment expense liabilities, and the actuarial consultants determined the recorded amounts were reasonably stated. The Property and Casualty Actuarial Unit of the NJDOBI, Office of Solvency Regulation, performed a review and evaluation of the outstanding gross and net loss and loss adjustment expense reserves. This review determined the year-end loss provisions established by the Company were reasonably stated.

Note 3 - Capital and Surplus

The Company reported surplus as regards policyholders at December 31, 2019 of \$59,762,969 which consisted of common stock of \$4,200,000, gross paid in and contributed surplus of \$63,450,000, and unassigned funds of (\$7,887,031).

The Company was determined to be in compliance with the minimum capital and surplus requirements of the State of New Jersey at December 31, 2019.

SUMMARY OF EXAMINATION RECOMMENDATIONS

There were no comments and/or recommendations deemed necessary for purposes of this examination report.

COMMITMENTS AND CONTINGENCIES

The Company and its subsidiary, WIC, are routinely involved in claims, lawsuits, regulatory audits, investigations and other legal matters arising, for the most part, in the ordinary course of

managing a property and casualty business. The Company believes that the legal actions, regulatory matters, proceedings and investigations currently pending against it should not have a material adverse effect on the results of operations, financial condition or liquidity based on their current knowledge and taking into consideration current accruals.

SUBSEQUENT EVENTS

The NJDOBI is monitoring the impact of the COVID-19 global pandemic. The NJDOBI recognizes that COVID-19 could have a significant financial and operational impact on all of its domestic insurers, including the Company. As such, the NJDOBI will continue to monitor and share information with the Company as appropriate related to COVID-19 developments.

On October 8, 2020, the Company received a capital contribution of \$1.2 million in the form of cash from parent Watford Holdings (U.S.) Inc.


In November 2020, Arch Capital and Watford Holdings Ltd. entered into a definitive agreement under which Arch Capital will acquire all of the common shares of Watford Holdings Ltd. At December 31, 2019, Arch Capital owned approximately 13% of the Watford Holdings Ltd. common shares. The acquisition is pending final regulatory approvals, and the Company expects the transaction to be finalized during the second quarter of 2021.

CONCLUSION

A regular statutory financial condition examination was conducted by the undersigned with the assistance of examiners of the New Jersey Department of Banking and Insurance examination staff.

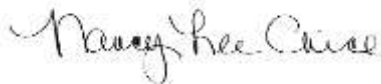
The examination and audit was conducted remotely. The courteous assistance and cooperation of the Company's management is acknowledged.

Respectfully submitted,



Darin Benck, CFE
Examiner-in-Charge
Risk & Regulatory Consulting, LLC
Representing the New Jersey Department of Banking and Insurance

Under the Supervision of,



Nancy Lee Chice, CFE
CFE Reviewer – Supervising Examiner
New Jersey Department of Banking and Insurance

Watford Specialty Insurance Company

The undersigned hereby certifies that an examination has been made of Watford Specialty Insurance Company and the foregoing report is true to the best of my knowledge and belief.

Respectfully submitted,

Darin Benck

Darin Benck, CFE
Examiner-in-Charge
Representing the New Jersey Department of Banking and Insurance

Under the Supervision of,

Nancy Lee Chice

Nancy Chice, CFE
CFE Reviewer – Supervising Examiner
New Jersey Department of Banking and Insurance

State of New Jersey
County of Mercer

Subscribed and sworn to before me, on this 28th day of May, 2020.

Sheila M. Thores

Notary Public of New Jersey

My commission expires: July 2025