

KBRA Assigns Ratings to Watford Holdings Ltd. and its Operating Subsidiaries

NEW YORK, NY (June 11, 2018) – Kroll Bond Rating Agency (KBRA) assigns insurance financial strength ratings (IFSR) of A to the operating subsidiaries of Watford Holdings Ltd. (Watford Holdings) – Watford Re Ltd.; Watford Insurance Company Europe Limited; Watford Specialty Insurance Company; and Watford Insurance Company (collectively referred to as Watford). KBRA also assigns an issuer rating of BBB+ to Watford Holdings. Additionally, KBRA assigns a rating of BBB- to Watford Holdings' outstanding cumulative contingently redeemable preference shares. The Outlook for all ratings is Stable.

The ratings reflect Watford's sound financial condition, diversified risk profile and seasoned management team. Watford is a total return global (re)insurer that combines underwriting medium- to long-tail casualty risks with an investment strategy focused on non-investment grade credit assets to generate attractive operating returns. Experienced, disciplined underwriting is provided by Arch Underwriters Ltd. and Arch Underwriters, Inc., both wholly owned subsidiaries of Arch Capital Group Ltd. (Arch) [NASDAQ: ACG], in accordance with Watford's guidelines that specifically limit exposure to natural catastrophes and other shorter tail risks. HPS Investment Partners, LLC (HPS) is a New York-based global investment platform with a focus on non-investment grade credit that manages approximately two-thirds of Watford's assets based on guidelines formulated to complement Watford's underwriting portfolio. Watford enjoys a good flow of high quality business from its strategic relationship with Arch.

Operations are supported by a comprehensive risk management framework and processes that leverage the risk management infrastructures in place at both Arch and HPS. Watford overlays its own proprietary analytics, risk appetites and risk controls onto the information from its service providers for an integrated approach to monitoring and reviewing its exposures. Underwriting leverage is prudently conservative as Watford opportunistically grows its business in the near- to medium-term. Asset/liability management is focused on mitigating the potential of being required to meet liquidity needs by selling assets in a distressed market. Finally, Watford maintains conservative financial leverage with good interest coverage and has adequate access to multiple sources of additional capital to facilitate execution of its business plans.

Balancing these strengths is Watford's limited operating history, significant enterprise risk due to its leveraged, non-traditional investment strategy and potential liquidity issues in a scenario with simultaneous shock underwriting losses combined with a severe investment market dislocation. KBRA believes that while it is common for (re)insurers to outsource some or all of their investment function, the outsourcing of the underwriting function has potential downsides, though in Watford's case those are offset by the long duration of the service agreements between Watford and Arch as well as the favorable cancellation/non-renewal provisions in those agreements. KBRA notes Watford's considerable exposure to credit risk as its asset portfolio is largely allocated to below-investment grade fixed-income assets. Watford performs extensive stress testing on a quarterly basis to ensure the organization's key risks are manageable both on an individual and collective basis.

Watford operates in a competitive reinsurance market awash with traditional and alternative capital creating a supply/demand imbalance, but is countering this situation by expanding into primary insurance in both Europe and the United States to deploy capital to areas of the market with the highest return potential, regardless of the underwriting cycle. Still, KBRA believes that Watford's lack of a fully developed Brexit plan for its Gibraltar subsidiary

could potentially negatively impact Watford's ability to service existing clients and to expand that business further in continental Europe.

The Stable Outlook reflects KBRA's expectation that Watford will continue to maintain sound capitalization while prudently executing its business plans. Additionally, KBRA expects Watford to maintain sufficient liquidity to cover projected liability cash flows and payment of preferred dividends.

The ratings are based on KBRA's [Global Insurer & Insurance Holding Company Rating Methodology](#) published on October 10, 2017.

A full report will soon be available on www.kbra.com.

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