

Explanatory Statement to Agenda item No: 2 of the Extraordinary General Assembly meeting to be held on 13/08/2020 – Inspection by the Central Bank of Bahrain

This Explanatory Statement is an important document and should be read in conjunction with the invitation to the Extraordinary General Meeting to be held on 13/08/2020.

Background

The Central Bank of Bahrain (CBB) had conducted an onsite inspection during the period 8 April to 16 June 2019 and issued the examination report on 14 July 2019. This explanatory statement summarizes the significant points/ lapses reported by the CBB and Arig's response for the information of the shareholders:

a. *Runoff without approval of CBB & EGM*

Part of the CBB's findings during the examination period was that Arig has taken number of crucial steps, which in effect amount to the effective implementation of the run off decision, during early 2019 without obtaining prior approval from the Central Bank of Bahrain and the Shareholders in the Extraordinary General Meeting violating Article 50 of the CBB Law and Article 210 of the Bahrain Commercial Companies Law among others CBB Rulebook Volume 3 provisions. These steps include:

- i. The Board decision to stop underwriting Lloyd's business on 21 January 2019 (which represents 47.8% of the gross written premium);*
- ii. The Board decision to withdraw from AM Best rating agency on 13 February 2019, without any alternative arrangement;*
- iii. The decision and the commencement of the termination of all overseas offices, subsidiaries and branches; and*
- iv. The allowing of vacancies in critical management positions arising on account of terminations / resignations without finding suitable replacements.*
- v. The recommendation to Shareholders during the Annual General Meeting held on 28 March 2019 to delist Arig shares from Dubai Financial Market (DFM)*

Arig would like to clarify that all the above decisions were taken to improve the operating efficiency and to preserve shareholder value and it had no intention to carry out run off without obtaining proper approval from the CBB and Shareholders. The details are provided below:

- a. The decision to stop writing Lloyds business in January 2019 was mainly due to losses of US\$ 48.9 million it has incurred from inception to date and significant downside risk going forward.

- b. AM Best rating was withdrawn by ARIG due to the initial downgrade in the year 2018 and the indication by AM Best of an imminent downgrade of one and possibly two notches because of ARIG's 2018 performance. Since any further downgrade would negatively affect ARIG more than remaining without rating, ARIG had withdrawn AM Best rating and was in fact evaluating the possibility of obtaining a rating from another agency.
- c. The decision to close Arig's Subsidiary Arig Insurance Management (DIFC) and voluntarily liquidate Gulf Warranties was a commercial decision. Arig Insurance Management (DIFC) could not commence its operations despite obtaining license in December 2016, and its capital has eroded because of operating expenses. The decision to commence the voluntary liquidation of another subsidiary Gulf Warranties was as required under Bahrain Commercial Companies Law due the erosion of its entire capital. At the time ARIG had failed because of oversight to obtain a specific approval for liquidation from the CBB. The recommendation to close the representative office at Mauritius office was more of economic decision as ARIG believed it can manage the marketing activities from Bahrain more economically.
- d. The key reasons for ARIG's inability to fill the noted vacancies are due to the present difficulties to attract experienced talent and / or right candidate and some of the positions (other than mandatorily required positions) were merged and as a result became redundant due to current staff reorganizations to reduce operational costs.

b. Disclosure

The CBB has revealed during its examination, that the Chairman of Arig , exchanged emails on 21 April 2019 between himself and employees of Emirates Investment Authority ("EIA") and General Pension and Social Security Authority ("GPSSA"), who are major shareholder of Arig, revealed confidential information about ARIG's strategic initiatives and proposed actions in response to CBB's formal direction, thereby making employees other than approved representatives aware of such confidential information.

Arig: Given the strategic role of both EIA and GPSSA in the GCC market who are also holding Corporate Directorship in ARIG, the Chairman sought out expertise from seasoned government institutional investment arms and certainly did not seek to benefit one class of shareholder over another. Notwithstanding, the BoD agrees that enhanced monitoring controls will be in place in relation to sensitive information ". Arig is committed to the rules and regulations and standards administered by the CBB.

c. Compliance Function

CBB has pointed out that Compliance testing program capturing the Company's compliance status relative to the CBB Rulebook and other relevant regulations was not updated since 2016 and did not extend to cover the requirements stipulated in the Bahrain Commercial Companies Law. Such gaps have caused compliance monitoring to be ineffective and resulted in a violation of the CBB Rulebook, High Level Controls (HC) Module, highlighting the failure of the Board to monitor Management performance and

review regularly the level of risks facing the Company which constitutes a violation of Paragraph HC-1.2.2(d) and (e) of High Level Controls (HC) Module of the CBB Rulebook (Volume 3).

Arig: The excel file containing the CBB Regulations was prepared until the year 2016 and all the subsequent amendments to the CBB Rulebook were reviewed separately as and when CBB quarterly updates were released and its applicability to ARIG was verified. This is evidenced by the updates provided by the Compliance Department to the ARC as a regular agenda item for the ARC.

The amendments to the Bahrain Commercial Companies Law were reviewed separately during the year 2018 and resulting amendments to the Articles of Association have been implemented. Further, a separate checklist is maintained for each activity such as conducting the AGM/EGM, notifications required and other matters of corporate governance. In addition, the Bahrain Labour Law was reviewed to ensure ARIG's compliance during the year 2018.

d. Gulf Warranties W.L.L. - Fraud and Provisioning

The Central Bank of Bahrain has pointed out that Subsequent to the fraud incident at Gulf Warranties W.L.L (GWL), USD 21.5 million provisions were booked in GWL, despite it being a limited liability company, and consequently similar provisions were made in the consolidated financials of ARIG based on the estimates of the Head of Risk and Actuarial Department at that point in time. Due to the extent of this substantial provision that had adversely affected the Company's book, ARIG should have, at least, commissioned an independent actuarial assessment of the purported loss to assess and determine the fair estimate, but, strangely, relied on its internal estimate and let such huge provision adversely affect its financial position.

ARIG wanted to restrict the loss provision only to the extent of Gulf Warranties W.L.L. (GWL) equity, but the external auditors did not agree citing the requirement of accounting standards required for consolidation. The actuarial assessment of the probable loss was based on estimates prepared by ARIG's qualified actuary.

Notwithstanding, Arig as part of the 2019 year-end exercise has engaged external actuaries to do a complete review of reserves relating to GWL. The external actuaries' estimate is also leading to a probable loss amounting to US\$ 21.5 million.

e. Internal Audit

The CBB has also pointed out that the Company's internal audit function ("IA") had failed to adequately conduct regular and comprehensive audit exercises over ARIG and its subsidiaries with absence of specific follow up reports for subsidiaries for audit findings . Specifically, in relation to GWL, the IA reports show that GWL was reviewed under a limited scope only every three years, even though many of the raised observations were of a high-risk nature, according to IA's scoring system.

ARIG believes that while there is always scope to improve the functioning of the Internal Audit department, we believe that the audits that were carried out were in line with best

audit practices. This was also confirmed by an external audit firm in the "Strategic Performance Review" report of the Internal Audit department, which was conducted during December 2015. The external audit firm's overall assessment is that the ARIG Internal Audit function generally conforms with the Standards of the Institute of Internal Auditors, demonstrates expertise in insurance governance, risk and control, evolved to a level of maturity that enables it to establish an overall assessment of the control environment across ARIG.

In relation to the audit cycles and scope applicable to subsidiaries, particularly relating to GWL, the audits of GWL conducted in 2008, 2011 and 2015 were in fact full-scope internal audit reviews and not a limited scope audit. In all of the audits, the audit score was a "4" (on a scale of 1 to 5, where 5 indicates the worst audit score due to significant audit findings of major concern). The review following the whistle-blowing event that took place in 2018 was only a specific review covering the areas mentioned in the whistle blower's complaints to establish the validity of those complaints and thus it was not a broader scope audit as mentioned in the Report

As a general point in relation to risk rating and audit review cycles of subsidiaries, the BoD does agree that a higher frequency of audits in relation to subsidiaries would be justifiable based on the Internal Audit department's risk rating methodology and this will be addressed going forward.

f. Concealment of Information

The CBB has revealed that certain emails exchanged between the Acting CEO and the Board, as well as all emails between Shareholder Affairs Department and the Board were not provided for during the onsite inspection.

ARIG takes a pro-active approach in its relationship with the CBB and the BoD as well as the ARIG Management Team are committed to ensuring transparency in all their dealings with the CBB. To illustrate: the BoD refers to the preliminary meeting of the CBB inspection team with the ARIG Management Team ahead of the inspection itself in which ARIG expressed that it will make every effort to facilitate access to all information requested by the CBB.

Meanwhile, at no point any specific, deliberate effort was made to conceal emails from the CBB team. The concerned individuals themselves had relied on the instructions given by the CBB. In this context, please note that there is no designated email address for the BoD and shareholders and that the only email addresses used to communicate with either BoD or shareholders is via personal email addresses. Reliance was placed on the "inbox" and "sent items" folders of individual employees in providing the details. In future, ARIG information technology department will obtain precise parameters of any such request and satisfy specific information requests of the CBB.

Disclaimer:

"The Central Bank of Bahrain assumes no responsibility for the accuracy and completeness of the information contained in this explanatory statement and expressly disclaims any liability whatsoever for any loss howsoever arising from reliance upon the whole or any part of the contents of this statement. The directors of ARIG confirm the accuracy of the contents of the information contained in this statement, which has been

prepared with due care. To the best of the knowledge and belief of the directors, who have taken all reasonable care to ensure that such is the case, the information contained in this statement is in accordance with the facts and contains no omissions likely to affect the importance and completeness of the statement. The Licensee's responses to CBB violations identified in the 'Inspection Report' needs to be independently weighed by the shareholders at the EGM, in the light of any evidentiary documents presented by the Licensee. The CBB does not take ownership to negate or accept any of the Licensee's response. The usual CBB supervisory process shall factor in the Licensee's response to the CBB findings and appropriate actions shall be taken accordingly."