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Syndicate Financial Statements Under UK GAAP

Arcus Syndicate 1856

31 December 2016

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DIRECTORS AND ADMINISTRATION

Managing Agent

Barbican Managing Agency Limited

Directors

D M Booth	(Resigned 15 March 2016)
I J Bremner	(Appointed 23 August 2016)
W T B Canagaretina	(Resigned 15 March 2016)
H N A Colthurst	
O R P Corbett	(Resigned 15 March 2016)
C R Cunningham	
A D Elliott	(Appointed 8 September 2016)
J J S Godfray	(Resigned 15 March 2016)
S A Godsave	(Appointed 15 March 2016)
M J Harrington	
J W Heap	(Appointed 15 March 2016)
R H Hobbs	
R A Keers	(Appointed 20 January 2017)
D E Reeves	(Resigned 24 August 2016)

Managing Agent's Registered Office

33 Gracechurch Street
London
EC3V 0BT

Managing Agent's Registered Number

06948515

Company Secretary

S J Britt

Syndicate Active Underwriter

Nicky Payne

Bankers

Lloyds Bank plc
Citibank NA
RBC Investor and Treasury Services

Auditor

Ernst & Young LLP
25 Churchill Place
Canary Wharf
London
E14 5EY

REPORT OF THE DIRECTORS OF THE MANAGING AGENCY

The Directors of the Managing Agent (“the Agency”) present their annual report and financial statements for the year ended 31 December 2016 for Syndicate 1856 (“the Syndicate”).

These financial statements are prepared using the annual basis of accounting as required by Statutory Instrument No 1950 of 2008, The Insurance Accounts Directive (Lloyd’s Syndicate and Aggregate Accounts) Regulations 2008 (“Lloyd’s Regulations 2008”).

Managing Agent

The Managing Agent of the Syndicate since its inception on 1 January 2016 is Barbican Managing Agency Limited (“the Agency”), whose registered office is situated at 33 Gracechurch Street, London, EC3V 0BT and whose registered number is 06948515.

Principal Activity

The principal activity of the Syndicate is the transaction of general reinsurance business in the Property, Energy and Whole Account Quota Share with Syndicate 1955.

The result for calendar year 2016 is a total loss for the year of (£1.48m). This is analysed further below.

The loss in the first year of the Syndicate is expected as expenses are largely earned in year one and in comparison premium earnings are only 55% earned at 31 December 2016.

Key Performance Indicators

The Syndicate’s key financial performance indicators during the year were as follows:

	£000
Gross premiums written	84,686
Gross premiums earned	49,516
Net premiums earned	35,032
Net claims incurred	(21,298)
Investment return	28
Operating expenses	(15,413)
Realised and unrealised movements on foreign exchange	170
Loss for the year	<u>(1,481)</u>
Claims ratio	60.8%
Expense ratio	44.0%
Combined ratio	104.8%

REPORT OF THE DIRECTORS OF THE MANAGING AGENCY (CONTINUED)

Review of the Business

For 2016, the Syndicate underwrote with an authorised capacity base of £89.2m. It underwrote for third party investors who supported the overall Syndicate underwriting through its corporate members.

For the 2016 Year of Account, the Syndicate reinsured Syndicate 1955 under a 15.4% whole account quota share contract.

The Syndicate writes five different lines of business. In 2016, these lines of business produced of £84.7m gross written premium. The five lines of business are as follows:

Property Reinsurance

The Property Reinsurance book includes proportional treaty, CAT excess of loss and risk excess of loss business in a globally diversified portfolio. In 2016 this class of business generated gross written premium of £32.9m.

Energy

The Energy book consists of four quota shares with a diversified profitable portfolio. In 2016, this class generated gross written premium of £9.1m.

Space

The Space book wrote two quota shares in 2016. This class generated gross written premium of £0.3m.

Cyber

The Syndicate has a small participation on a Cyber consortium led by Syndicate 1955 who have taken a cautious and conservative approach to writing this book. This class generated gross written premium of £1.4m.

Whole Account Lloyd's Quota Share

The Whole Account Lloyd's Quota Share consists of business written by Syndicate 1955 on a whole account net basis. This is net of reinsurance spend, claims and expenses. The percentage of the cession is 15.4%. In 2016 this class generated gross written premium of £41m.

Business Environment

Overall the portfolio experienced a good first year despite downwards pressure on ratings, resulting in a difficult trading environment. The effects were particularly felt in Energy and Property classes.

Investment Returns

Due to the Syndicate's infancy, investment return is low as currently funds are held in trust fund accounts.

As the Syndicate grows the Syndicate will still hold funds in short-term cash deposits and opportunities to invest on a prudent basis by the Syndicate's investment manager, New England Asset Management, Inc. will be looked into.

Overall investment yield for 2016 for the year is at £28k.

Principal Risks and Uncertainties

The Board of the Agency ("Agency Board") sets risk appetite annually as part of the Syndicate's business planning and individual capital assessment process. The Agency has developed a risk and control framework

REPORT OF THE DIRECTORS OF THE MANAGING AGENCY (CONTINUED)

Principal Risks and Uncertainties (continued)

which is built on an Enterprise Risk Management Model that aims to integrate existing risk programmes into a more holistic, embedded risk and capital management framework. This is reviewed annually as part of the Syndicate Business Forecast ("SBF") and Solvency Capital Requirement ("SCR") process.

The principal risks and uncertainties faced by the Syndicate and Agency were as follows:

Insurance Risk

Insurance risk includes the risks that a policy will be written for inadequate premium or provide inappropriate cover (underwriting risk), that the frequency or severity of insured events will be higher than expected (claims risk), and that estimates of claims subsequently prove to be insufficient (reserving risk). The Agency Board oversees insurance risk by agreeing its appetite for these risks annually and managing this primarily through the business plan, which sets out targets for volumes, pricing, line sizes and retention by class of business. The Agency Board then monitors performance against the business plan regularly throughout the year. Catastrophe modelling software is used to model maximum probable losses from catastrophe-exposed business. Reserve adequacy is monitored through a quarterly review by the Syndicate actuary and reviewed annually by an independent firm of actuaries.

Credit Risk

The key aspect of credit risk is the risk of default by one or more of the Syndicate's reinsurers. The Agency's policy is that the Syndicate generally reinsures with businesses rated A- or higher by one or more rating agencies. The Syndicate only uses reinsurers with lower ratings or that are completely unrated where collateral or a claims paying guarantee from a parent undertaking is provided. As at 31 December 2016, the Syndicate had £66.1m of collateral.

Currency Risk

The key aspect of currency risk is the risk of losses on foreign exchange movements as a result of mismatches between the currencies in which assets and liabilities are denominated. The Agency Board's policy is to maintain all assets and liabilities in the core currencies in which they were received or paid (as the case may be). Any surplus or deficit in a core currency is subject to review by the Agency Board, which may instruct surplus currencies to be sold to reduce a deficit on other currencies.

Liquidity Risk

This is the risk that the Syndicate will not be able to meet its liabilities as they fall due, owing to a shortfall in cash. To mitigate this risk, the Agency Board reviews cash flow projections regularly and ensures the Syndicate holds adequate liquid investments in its portfolios.

Group Risk

Group risk is the possibility that the operation of one part of the Group adversely affects another.

Group risk includes: negative publicity; inadequate communication within the organisation; undue influence from fellow subsidiaries, holding companies or stakeholders; financial pressures to make funds available to the Group; and financial restraint leading to shortcomings in core activities such as reinsurance purchasing.

The Agency's strategy is to minimise any Group risk by ensuring that there are clear lines of authority and communication between related parties, that intra-Group reinsurance is placed on arm's length terms and that any intra-Group agreements are clearly understood and observed by all parties.

REPORT OF THE DIRECTORS OF THE MANAGING AGENCY (CONTINUED)

Operational Risk

This is the risk that errors caused by people, processes or systems lead to losses to the Syndicate. The agency Board seeks to manage this risk through the use of policies, procedures, management controls, risk-based compliance monitoring, and a structured programme of testing processes and systems by internal audit. Business continuity and disaster recovery plans are in place and are regularly updated.

Regulatory Risk

The Agency is required to comply internally with the requirements of the Financial Conduct Authority ("FCA"), the Prudential Regulation Authority ("PRA"), and the Society of Lloyd's (Lloyd's). Lloyd's requirements include those imposed on the Lloyd's market by overseas regulators, particularly in respect of US Situs business and certain EU regulators. Regulatory risk is the risk of regulatory intervention owing to a breach of regulatory requirements or failure to respond to regulatory change. The Agency Board has appointed the Barbican Group Head of Compliance and Risk as its Compliance Officer, who monitors regulatory developments, assesses the impact on the Agency's policies and process and reports to the Agency Board.

Market Risk

Market risk is the risk or uncertainty arising from possible market price movements and their impact on the future performance of a business.

Future Developments

The Syndicate will continue to transact the current classes of reinsurance business for the foreseeable future. A new direct Property Insurance class of business will be written in 2017.

Disclosure of Information to the Auditor

So far as each person who was a Director of the Agency at the date of approving this report is aware, there is no relevant audit information, being information needed by the auditor in connection with its report, of which the auditor is unaware. Having made enquiries of fellow Directors of the Agency and the Syndicate's auditor, each Director has taken all the steps that he is obliged to take as a Director in order to make himself aware of any relevant audit information and to establish that the auditor is aware of that information.

Reappointment of Auditor

Ernst & Young LLP are deemed reappointed as auditor of the Syndicate.

By order of the Board

C R Cunningham
Deputy Managing Director
15 March 2017

MANAGING AGENT'S RESPONSIBILITIES STATEMENT

The Agency is responsible for preparing the Syndicate Annual Accounts in accordance with applicable law and regulations.

The Insurance Accounts Directive (Lloyd's Syndicate and Aggregate Accounts) Regulations 2008 require the Agency to prepare Syndicate Annual Accounts at 31 December each year in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law). The Syndicate Annual Accounts are required by law to give a true and fair view of the state of affairs of the Syndicate as at that date and of its profit or loss for that year. In preparing the Syndicate Annual Accounts, the Agency is required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the notes to the Syndicate Annual Accounts; and
- prepare the Syndicate Annual Accounts on the basis that the Syndicate will continue to write future business unless it is inappropriate to presume that the Syndicate will do so.

The Agency is responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Syndicate and enable it to ensure that the Syndicate Annual Accounts comply with the Insurance Accounts Directive (Lloyd's Syndicate and Aggregate Accounts) Regulations 2008. It is also responsible for safeguarding the assets of the Syndicate and hence for taking reasonable steps for prevention and detection of fraud and other irregularities.

The Agency is responsible for the maintenance and integrity of the corporate and financial information included on the business' website. Legislation in the United Kingdom governing the preparation and dissemination of Annual Accounts may differ from legislation in other jurisdictions.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF ARCUS SYNDICATE 1856

We have audited the Syndicate Financial Statements Under UK GAAP of Syndicate 1856 ("the Syndicate") for the year ended 31 December 2016 which comprise the Income Statement, the Statement of Financial Position, the Statement of Changes in Members' Balances, the Statement of Cash Flows and the related notes 1 to 21. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

This report is made solely to the Syndicate's members, as a body, in accordance with The Insurance Accounts Directive (Lloyd's Syndicate and Aggregate Accounts) Regulations 2008. Our audit work has been undertaken so that we might state to the Syndicate's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Syndicate's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective Responsibilities of the Managing Agent and the Auditor

As explained more fully in the Statement of Managing Agent's Responsibilities set out on page 7, the Agency is responsible for the preparation of Syndicate Financial Statements Under UK GAAP which give a true and fair view. Our responsibility is to audit and express an opinion on the Syndicate Financial Statements Under UK GAAP in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the Audit of the Syndicate Financial Statements Under UK GAAP

An audit involves obtaining evidence about the amounts and disclosures in the Syndicate Financial Statements Under UK GAAP sufficient to give reasonable assurance that the Syndicate Financial Statements Under UK GAAP are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Syndicate's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Agency; and the overall presentation of the Syndicate Financial Statements Under UK GAAP. In addition, we read all the financial and non-financial information in the Syndicate Financial Statements Under UK GAAP to identify material inconsistencies with the audited Syndicate Financial Statements Under UK GAAP and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies, we consider the implications for our report.

Opinion on Syndicate Financial Statements Under UK GAAP

In our opinion the Syndicate Financial Statements Under UK GAAP:

- give a true and fair view of the Syndicate's affairs as at 31 December 2016 and of its loss for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice, including Financial Reporting Standard 102 'The Financial Reporting Standard applicable in the UK and Republic of Ireland' and Financial Reporting Standard 103 'Insurance Contracts'; and
- have been prepared in accordance with the requirements of The Insurance Accounts Directive (Lloyd's Syndicate and Aggregate Accounts) Regulations 2008.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF ARCUS SYNDICATE 1856 (CONTINUED)

Opinion on Other Matter Prescribed by The Insurance Accounts Directive (Lloyd's Syndicate and Aggregate Accounts) Regulations 2008

In our opinion, the information given in the Managing Agent's Report for the financial year in which the Syndicate Financial Statements Under UK GAAP are prepared is consistent with the Syndicate Financial Statements Under UK GAAP.

Matters on which we are Required to Report by Exception

We have nothing to report in respect of the following matters where The Insurance Accounts Directive (Lloyd's Syndicate and Aggregate Accounts) Regulations 2008 requires us to report to you, if in our opinion:

- the Agency in respect of the Syndicate has not kept adequate accounting records; or
- the Syndicate Financial Statements Under UK GAAP are not in agreement with the accounting records;
or
- we have not received all the information and explanations we require for our audit.

Benjamin Gregory (Senior statutory auditor)

for and on behalf of Ernst & Young LLP, Statutory Auditor

London

17 March 2017

INCOME STATEMENT

Technical Account – General Business

For the year ended 31 December 2016

	Notes	2016 £000
Gross premiums written	2	84,686
Outward reinsurance premiums		(20,565)
Net premiums written		64,121
Change in the provision for unearned premiums:		
- Gross amount		(35,170)
- Reinsurers' share		6,081
Change in the net provision for unearned premiums	10	(29,089)
Earned premiums, net of reinsurance	10	35,032
Allocated investment return transferred from non-technical account	3	28
Claims paid		
- Gross amount	11	(4,283)
- Reinsurers' share	11	922
Net claims paid		(3,361)
Change in claims outstanding		
- Gross amount		(28,018)
- Reinsurers' share		10,081
Change in the net provision for claims	11	(17,937)
Claims incurred, net of reinsurance	11	(21,298)
Net operating expenses	4	(15,413)
Balance on the technical account for general business		(1,651)

INCOME STATEMENT

Non-Technical Account – General Business

For the year ended 31 December 2016

	Notes	2016 £000
Balance on the general business technical account		(1,651)
Investment income	3	28
Allocated investment return transferred to general business technical account		(28)
Foreign exchange gain		170
Loss for the year		(1,481)

STATEMENT OF CHANGES IN MEMBERS' BALANCES

For the year ended 31 December 2016

	2016
	£000
At 1 January	-
Loss for the year	(1,481)
At 31 December	<u>(1,481)</u>

STATEMENT OF FINANCIAL POSITION

ASSETS

As at 31 December 2016

	Notes	2016 £000
Investments		
Financial investments	8	22,460
Reinsurers' share of technical provisions		
Provision for unearned premiums	10	6,540
Claims outstanding	11	10,883
		<u>17,423</u>
Debtors		
Debtors arising out of reinsurance operations	14	26,670
Other debtors		<u>275</u>
		26,945
Other assets		
Cash at bank and in hand	12	7,232
Other deposits	12	<u>97</u>
		7,329
Deferred acquisition costs	13	<u>4,049</u>
		4,049
Total assets		<u><u>78,206</u></u>

STATEMENT OF FINANCIAL POSITION

MEMBERS' BALANCES AND LIABILITIES

As at 31 December 2016

	Notes	2016 £000
Members' balances and liabilities		
Members' balances		(1,481)
Liabilities		
Technical provisions		
Provision for unearned premiums	10	37,921
Claims outstanding	11	30,160
		<u>68,081</u>
Creditors due within one year		
Other creditors	15	11,531
		<u>11,531</u>
Accruals and deferred income	5	75
Total liabilities		<u>78,206</u>
Total members' balances and liabilities		<u>78,206</u>

The Annual Accounts on pages 11 to 48 were approved by the Board of Barbican Managing Agency Limited on 13 March 2017 and were signed on its behalf by

C R Cunningham

Deputy Managing Director

15 March 2017

STATEMENT OF CASH FLOWS

For the year ended 31 December 2016

	Notes	2016 £000
Cash flows from operating activities		
Loss for the financial year		(1,481)
Adjustments for		
Movement in general insurance unearned premiums and outstanding claims	10, 11	
Movement in reinsurers' share of unearned premiums and outstanding claims	10, 11	68,081
		(17,423)
Investment return	3	(28)
Movements in other assets/liabilities		(30,919)
Net cash from operating activities		<hr/> 18,230
Cash flows from investing activities		
Purchase of equity and debt instruments		(22,460)
Investment income received		28
Other (Overseas Deposits)		(97)
Net cash from investing activities		<hr/> (22,529)
Cash flows from financing activities		
Other	15	11,531
Net cash from financing activities		<hr/> 11,531
Net increase in cash and cash equivalents		7,232
Cash and cash equivalents at the beginning of the year		-
Cash and cash equivalents at the end of the year	12	<hr/> <hr/> 7,232

NOTES TO THE FINANCIAL STATEMENTS

1. Significant Accounting Policies

a. Statement of Compliance

The financial statements have been prepared in compliance with FRS 102 and FRS 103, being applicable UK GAAP accounting standards and the “Insurance Accounts Directive” (Lloyd’s Syndicate Accounts) Regulations 2008.

The financial statements are prepared under the historical cost convention except for certain financial instruments which are measured at fair value.

b. Basis of Preparation

The financial statements for the year ended 31 December 2016 were approved for issue by the Board on 13 March 2017.

The financial statements are prepared in Sterling which is the presentational and functional currency of the Syndicate and rounded to the nearest £000.

c. Judgements and Key Sources of Estimation Uncertainty

The preparation of the financial statements requires management to make judgements, estimates and assumptions that affect the amounts reported for assets and liabilities as at the statement of financial position date and the amounts reported for revenues and expenses during the year. However, the nature of estimation means that actual outcomes could differ from those estimates. The following are the key sources of estimation uncertainty:

Insurance Contract Technical Provisions

For insurance contracts, estimates have to be made both for the expected ultimate cost of claims reported at the reporting date and for the expected ultimate cost of claims incurred, but not yet reported, at the reporting date (IBNR). It can take a significant period of time before the ultimate claims cost can be established with certainty and for some type of policies, IBNR claims form the majority of the liability in the statement of financial position.

The ultimate cost of outstanding claims is estimated by using a range of standard actuarial claims projection techniques, such as Chain Ladder and Bornheutter-Ferguson methods.

The main assumption underlying these techniques is that past claims development experience can be used to project future claims development and hence ultimate claims costs. As such, these methods extrapolate the development of paid and incurred losses, average costs per claim and claim numbers based on the observed development of earlier years and expected loss ratios. Historical claims development is mainly analysed by underwriting years, but can also be further analysed by geographical area, as well as by significant business lines and claim types. Large claims are usually separately addressed, either by being reserved at the face value of loss adjuster estimates or separately projected in order to reflect their future development. In most cases, no explicit assumptions are made regarding future rates of claims inflation or loss ratios. Instead, the assumptions used are those implicit in the historical claims development data on which the projections are based. Additional qualitative judgement is used to assess the extent to which past trends may not apply in future, (e.g. to reflect one-off occurrences, changes in external or market

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

1. Significant Accounting Policies (continued)

c. Judgements and Key Sources of Estimation Uncertainty (continued)

Insurance Contract Technical Provisions (continued)

factors such as public attitudes to claiming, economic conditions, levels of claims inflation, judicial decisions and legislation, as well as internal factors such as portfolio mix, policy features and claims handling procedures) in order to arrive at the estimated ultimate cost of claims that present the most likely outcome from the range of possible outcomes, taking account of all the uncertainties involved.

A number of judgements and assumptions are used in assessing salvage and subrogation recoveries.

Similar judgements, estimates and assumptions are employed in the assessment of adequacy of provisions for unearned premium. Judgement is also required in determining whether the earnings methodology on an insurance contract requires amortisation of unearned premium on a basis other than time apportionment.

Estimates of Future Premiums

For certain insurance contracts, premium is initially recognised based on estimates of ultimate premiums. These estimates are judgemental and could result in misstatements of revenue being recorded in the financial statements.

The main assumption underlying these estimates is that past premium development can be used to project future premium development.

d. Financial Instruments

As permitted by FRS 102, the Syndicate has elected to apply the recognition and measurement provisions of IAS 39 - Financial Instruments (as adopted for use in the EU) to account for all of its financial instruments.

Cash and Cash Equivalents

Cash and cash equivalents in the statement of financial position comprise cash at banks and in hand and short term deposits with an original maturity date of three months or less. For the purpose of the cash flow statement, cash and cash equivalents consist of cash and cash equivalents as defined above, net of outstanding bank overdrafts.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

1. Significant Accounting Policies (continued)

d. Financial Instruments (continued)

Fair Value of Financial Assets

The Syndicate uses the following hierarchy for determining the fair value of financial instruments by valuation technique:

- **Level 1:** The unadjusted quoted price in an active market for identical assets or liabilities that the Syndicate can access at the measurement date.
- **Level 2:** Inputs other than quoted prices included within Level 1 that are observable (i.e. developed using market data) for the asset or liability, either directly or indirectly.
- **Level 3:** Inputs are unobservable (i.e. for which market data is unavailable) for the asset or liability.

See note 8 for details of financial instruments classified by fair value hierarchy.

Derecognition of Financial Assets

A financial asset or, when applicable, a part of a financial asset is derecognised when:

- The rights to the cash flows from the asset have expired; or
- The Syndicate retains the right to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full without material delay to a third party under a 'pass through' arrangement and either (a) the Syndicate has transferred substantially all the risks and rewards of the asset; or (b) the Syndicate has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

When the Syndicate has transferred its right to receive cash flows from an asset or has entered into a pass-through arrangement, and has neither transferred nor retained substantially all the risks and rewards nor transferred control of the asset, the asset is recognised to the extent of the Syndicate's continuing involvement in the asset. Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Syndicate could be required to repay. In that case, the Syndicate also recognises an associated liability.

Offsetting of Financial Instruments

Financial assets and financial liabilities are offset and the net amount is reported in the statement of financial position if, and only if:

- There is a currently enforceable legal right to offset the recognised amounts; and
- There is an intention to settle on a net basis, to realise the assets and settle the liabilities simultaneously.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

1. Significant Accounting Policies (continued)

d. Financial Instruments (continued)

Financial Liabilities

All financial liabilities are recognised initially at fair value and, in the case of loans and borrowings, net of directly attributable transaction costs.

Trade and other payables and loans and borrowings are subsequently measured at amortised cost using the effective interest method. Gains and losses are recognised in the income statement when the liabilities are derecognised as well as through the effective interest rate (EIR) method amortisation process.

Amortised cost is calculated by taking into account any discount or premium on acquisition and fee or costs that are an integral part of the EIR. The EIR amortisation is included in finance cost in profit or loss.

A financial liability is derecognised when the obligation under the liability is discharged or expires. When an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of the existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, and the difference in the respective amounts is recognised in profit or loss.

Guarantee

The Syndicate has cash collateral held in third party trusts, in respect of reinsurance arrangements with unrated counterparties. The rights and obligations are not with the Syndicate, but with the provider of the collateral and as such are not recognised as financial assets. There are no non-cash collateral arrangements in place. The Syndicate is not required to provide collateral for counterparties for which it is the reinsurer.

Financial assets and financial liabilities are offset and the net amount is reported in the statement of financial position if, and only if:

- There is a currently enforceable legal right to offset the recognised amounts; and
- There is an intention to settle on a net basis, to realise the assets and settle the liabilities simultaneously.

e. Investment Return

Interest income is recognised on an accruals basis based on the effective interest rate.

The actual investment return on investments supporting the technical provisions is made from the non-technical account to the technical account. Investment return related to non-insurance business is attributed to the non-technical account.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)**1. Significant Accounting Policies (continued)****f. Insurance Contracts***Product Classification*

Insurance contracts are those contracts when the Syndicate (the insurer) has accepted significant insurance risk from another party (the insured) by agreeing to compensate the insured if a specified uncertain future event (the insured event) adversely affects the insured. As a general guideline, the -agency determines whether it has significant insurance risk, by comparing benefits paid with benefits payable if the insured event did not occur. Insurance contracts can also transfer financial risk.

Once a contract has been classified as an insurance contract, it remains an insurance contract for the remainder of its lifetime, even if the insurance risk reduces significantly during this period, unless all rights and obligations are extinguished or expire.

Gross Premiums

Gross written premiums comprise the total premiums receivable for the whole period of cover provided by the contracts entered into during the reporting period, regardless of whether these are wholly due for payment in the reporting period, together with any adjustments to such premiums receivable arising in the reporting period to such premiums receivable in respect of business written in prior reporting periods. They are recognised on the date on which the policy commences. Additional or return premiums are treated as a remeasurement of the initial premium. Gross written premiums are stated gross of commission.

Gross written premiums include an estimate for pipeline premiums (i.e. premiums written in respect of policies which have not incepted by the reporting date) relating only to those underlying contracts of insurance where the period of cover has commenced prior to the reporting date. The most significant assumption in this estimate is that current year experience will be consistent with prior year experience.

Under some policies, gross written premiums are adjusted retrospectively in the light of claims experience or where the risk covered cannot be assessed accurately at the commencement of cover. Where written premiums are subject to an increase retrospectively, recognition of any potential increase is deferred until the additional amount can be ascertained with reasonable certainty. Where written premiums are subject to a reduction, a remeasurement taking account of such a reduction is made as soon as there is an obligation to the insured.

Written premiums are recognised as earned over the period of the policy on a time apportionment basis having regard where appropriate, to the incidence of risk. The provision for unearned premiums is predominantly calculated on a monthly pro rata basis with some classes of business such as Space having more complex earnings profiles. The proportion attributable to subsequent periods is deferred as a provision for unearned premiums.

Reinsurance Premiums

Reinsurance premiums written comprise the total premiums payable for the whole cover provided by contracts entered into the period, including portfolio premiums payable, and are

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

1. Significant Accounting Policies (continued)

f. Insurance Contracts (continued)

Reinsurance Premiums

recognised on the date on which the policy incepts. Premiums include any adjustments arising in the accounting period in respect of reinsurance contracts incepting in prior accounting periods.

Under some policies, reinsurance premiums payable is adjusted retrospectively in the light of claims experience or where the risk covered cannot be assessed accurately at the commencement of cover. Where written premiums are subject to an increase retrospectively, recognition of any potential increase is recognised as soon as there is an obligation to the insured.

Reinsurance premiums under a Risks Attaching During (“RAD”) contract are earned typically over two years based on inception and expiry dates. Year of Account allocation is based on the inception and expiry dates that the contract relates to. This results in a triangular earnings pattern, where earnings increase towards the middle of the policy period then decrease until the policy expires.

Reinsurance premiums under a Losses Occurring During (“LOD”) contract are earned on a straight line basis over the period of the reinsurance contract, based on inception and expiry dates. Losses that occur during the length of the contract could relate to the current, prior or following year of account, therefore an allocation to Year of Account is applied to this type of policy. The allocation is based on historical class level monthly earnings for the underlying gross policies.

Fees and Commission Income

Insureds are charged for policy administration services, investment management services, policy surrenders and other contract fees. These fees are recognised as revenue over the period in which the related services are performed. If the fees are for services to be provided in future periods, then they are deferred and recognised over those future periods.

Claims

Claims include all claims occurring during the year, whether reported or not, related internal and external claims handling costs that are directly related to the processing and settlement of claims, a reduction for the value of salvage and other recoveries, and any adjustments to claims outstanding from previous years.

Reinsurance claims are recognised when the related gross insurance claim is recognised according to the terms of the relevant contract.

Technical Provisions

Technical provisions comprise claims outstanding, provisions for unearned premiums, provisions for unexpired risks.

Claims Outstanding

The outstanding claims provision is based on the estimated ultimate cost of all claims incurred but not settled at the reporting date, whether reported or not, together with related claims handling costs and reduction for the expected value of salvage and other recoveries. Delays can be experienced in the notification and settlement of certain types of claims and therefore, the

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)**1. Significant Accounting Policies (continued)****f. Insurance Contracts (continued)***Claims Outstanding (continued)*

ultimate cost of these claims cannot be known with certainty at the reporting date. The liability is calculated at the reporting date using a range of standard actuarial claim projection techniques, based on empirical data and current assumptions that may include a margin for adverse deviation. The liability is not discounted for the time value of money.

These methods generally involve projecting from past experience of the development of claims over time to form a view of the likely ultimate claims to be experienced for more recent underwriting, having regard to variations in the business accepted and the underlying terms and conditions. For the most recent years, where a high degree of volatility arises from projections, estimates may be based in part on output from rating and other models of the business accepted and assessments of underwriting conditions.

Technical Provisions (continued)

The reinsurers' share of provisions for claims is based on the amounts of outstanding claims and projections for IBNR, net of estimated irrecoverable amounts, having regard to the reinsurance programme in place for the class of business, the claims experience for the year and the current security rating of the reinsurers involved. A number of statistical methods are used to assist in making these estimates.

The two most critical assumptions as regards claims provisions are that the past is a reasonable predictor of the likely level of claims development and that the rating and other models used for current business are fair reflections of the likely level of ultimate claims to be incurred.

The directors consider that the provisions for gross claims and related reinsurance recoveries are fairly stated on the basis of the information currently available to them. However, the ultimate liability will vary as a result of subsequent information and events and this may result in significant adjustments to the amounts provided. Adjustments to the amounts of claims provisions established in prior years are reflected in the Annual Accounts for the period in which the adjustments are made. The methods used, and the estimates made, are reviewed regularly.

Provisions for Unearned Premiums

Unearned reinsurance premiums are those proportions of reinsurance premiums in a year that relate to periods of risk after the reporting date. Unearned reinsurance premiums are deferred over the term of the underlying direct insurance policies for risks-attaching contracts and over the term of the reinsurance contract for losses-occurring contracts.

Unexpired Risks

A liability adequacy provision (the unexpired risks provision) is made where the cost of claims and expenses arising after the end of the financial year from contracts concluded before that date, is expected to exceed the provision for unearned premiums, net of deferred acquisition costs, and premiums receivable.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

1. Significant Accounting Policies (continued)

f. Insurance Contracts (continued)

Unexpired Risk (continued)

The assessment of whether a provision is necessary is made by considering separately each category of business on the basis of information available at the reporting date, after offsetting surpluses and deficits arising on products which are managed together. Investment income is taken into account in calculating the provision.

At 31 December 2016 the Syndicate did not have an unexpired risks provision.

Deferred Acquisition Costs

Acquisition costs comprise costs arising from the conclusion of insurance contracts. They include both direct costs, such as intermediary commissions or the cost of drawing up the insurance document or including the insurance contract in the portfolio, and indirect costs, such as the advertising costs or the administrative expenses connected with the processing of proposals and the issuing of policies.

Deferred acquisition costs are costs arising from conclusion of insurance contracts that are incurred during the reporting period but which relate to a subsequent reporting period and which are carried forward to subsequent reporting periods.

Deferred acquisition costs are amortised over the period in which the related premiums are earned.

Reinsurance Assets

The Syndicate cedes insurance risk in the normal course of business for all of its lines of business. Reinsurance assets represent balances due from reinsurance companies and other Lloyd's syndicates. Amounts recoverable from reinsurers are estimated in a manner consistent with the outstanding claims provision or settled claims associated with the reinsurer's policies and in accordance with the related reinsurance contract.

Reinsurance assets are reviewed for impairment at each reporting date, or more frequently should an indication of impairment arise during the reporting year. Impairment occurs when there is objective evidence as a result of an event that occurred after initial recognition of the reinsurance asset that the Syndicate may not receive all outstanding amounts due under the terms of the contract and the event has a reliably measurable impact on the amounts that the Syndicate will receive from the reinsurer. The impairment loss is recorded in the Income Statement.

Ceded reinsurance arrangements do not relieve the Syndicate from its insurance obligations to its policyholders.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

1. Significant Accounting Policies (continued)

f. Insurance Contracts (continued)

Insurance Receivables

Insurance receivables are recognised when due and measured on initial recognition at the fair value of the consideration received or receivable. Subsequent to initial recognition, they are measured at amortised cost, using the effective interest rate method. The carrying value of insurance receivables is reviewed for impairment should events or circumstances indicate that the carrying amount may not be recoverable, with the impairment loss recorded in the Income Statement.

Insurance receivables are derecognised when the derecognition criteria for financial assets have been met.

Insurance Payables

Insurance payables are recognised when due and measured on initial recognition at the fair value of the consideration received less directly attributable transaction costs. Subsequent to initial recognition, they are measured at amortised cost using the effective interest rate method. Insurance payables are derecognised when the obligation under the liability is settled, cancelled or expired.

g. Provisions

Provisions are recognised when the Syndicate has a present obligation as a result of a past event, and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.

h. Foreign Currencies

The Syndicate's functional currency and presentational currency is Sterling.

Transactions in US dollars, Canadian dollars, Euros, Australian dollars and Japanese Yen are initially recorded in the functional currency at the average rates of exchange for the period where for practical purposes it is not possible to use the actual rate at the date of transaction. Transactions denominated in other foreign currencies are included at the rate of exchange ruling at the date the transaction is processed.

Monetary assets and liabilities (which include unearned premiums and deferred acquisition costs) denominated in foreign currencies are translated at the rate of exchange at the statement of financial position date. Non-monetary items denominated in a foreign currency, measured at fair value are translated into the functional currency using the exchange rate ruling at the date when the fair value was determined.

Exchange differences arising on the retranslation of opening statement of financial position items at the closing statement of financial position rate and the retranslation of the Income Statement for the year from the average rate to the closing statement of financial position rate are recorded in the non-technical account.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

1. Significant Accounting Policies (continued)

i. Taxation

Under Schedule 19 of the Finance Act 1993 managing agents at Lloyd's are not required to deduct basic-rate income tax from trading income. In addition, all UK basic-rate income tax deducted from syndicate investment income is recoverable by the Agency and consequently the distribution made to members or their members' agents is gross of tax. Capital appreciation falls within trading income and is also distributed gross of tax.

No provision has been made for any United States Federal Income Tax payable on underwriting results or investment earnings. Any payments on account made by the Syndicate are included in the statement of financial position under the heading "other debtors".

No provision has been made for any overseas tax payable by members of the Syndicate on underwriting results.

j. Pension Costs

The Barbican Group of companies, of which the Agency is a member, operates a defined contribution pension scheme. Pension contributions relating to agency staff are charged to the Syndicate and included within net operating expenses.

k. Profit Commission

Profit commission is payable to the Agency at a rate of 17.5% on the Whole Account 1955 quota share and 10% on the Syndicate's other four classes of business. This is charged to the Syndicate as incurred but does not become payable until after the appropriate Year of Account closes, normally at 36 months.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

2. Segmental Analysis

Analysis by Class of Business

An analysis of the underwriting result before investment and FX is set out below:

2016	Gross premiums written £'000	Gross premiums earned £'000	Gross claims incurred £'000	Gross operating expenses £'000	Reinsuranc e balance £'000	Total £'000	Net technical provisions £'000
Reinsurance	84,686	49,516	(32,301)	(15,413)	(3,481)	(1,679)	(50,658)
	<u>84,686</u>	<u>49,516</u>	<u>(32,301)</u>	<u>(15,413)</u>	<u>(3,481)</u>	<u>(1,679)</u>	<u>(50,658)</u>

The reinsurance balance is the aggregate total of all those items included in the technical account which relate to reinsurance outwards.

All premiums were written in the UK.

Analysis by Geographical Location

The geographical analysis of premiums by destination (or location of risk) is as follows:

	2016 £000
UK	13,091
EU member states	6,242
US	52,507
Other	12,846
Gross premiums written	<u>84,686</u>

3. Investment Return

All of the Syndicate's investments are recognised at fair value through the profit and loss.

	2016 £000
Investment income	28
Total investment income	<u>28</u>
Net investment income	<u>28</u>

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

4. Net Operating Expenses

		2016 £000
Acquisition costs		11,363
Change in deferred acquisition costs	13	(4,542)
Administrative expenses		8,592
		<u>15,413</u>

Please see note 13 in reference to change in deferred acquisition costs.

Administrative expenses include:

	2016 £000
Members' standard personal expenses (Lloyd's subscriptions, New Central Fund contributions, Managing Agent's fees and profit commission)	<u>4,183</u>

The gain on the translation of monetary assets and liabilities at the reporting date of 31 December 2016 was £170k.

Included in administrative expenses are staff costs of £3,732. This is further broken down in note 6 below.

5. Auditor's Remuneration

	2016 £000
Audit of the Syndicate Annual Accounts	<u>75</u>
	<u>75</u>

The above represents the Syndicate's share of the total audit fee.

Auditors' remuneration is included as part of the administrative expenses in note 4 to the financial statements.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

6. Staff Costs and Directors' Remuneration

a. Staff Costs

All staff in the Barbican Group are employed by Barbican Holdings (UK) Limited ("BHUK"), the immediate parent company of the Agency. The following amounts were recharged to the Syndicate in respect of salary costs:

	2016
	£000
Wages and salaries	3,256
Social security costs	267
Other pension costs	209
	<u>3,732</u>

The average number of employees employed by BHUK, but working for the Syndicate during the year was as follows:

	2016
	No.
Administration and Finance	2
Underwriting	6
	<u>8</u>

b. Directors' Remuneration

The four executive Directors of the Agency, one of whom served throughout the year, received no remuneration in the year charged to the Syndicate.

The Syndicate's Active Underwriter received the following remuneration:

	2016
	£000
Aggregate remuneration in respect of qualifying services	<u>505</u>

No advances or credits granted by the Agency to any of its directors subsisted during the year. This includes non-cash benefits.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

7. Calendar Year Investment Yield

The average amount of Syndicate funds available for investment during 2016 and the investment return and yield for that calendar year were as follows:

	2016 £000
Average Syndicate funds available	
Sterling	905
Euro	3,232
United States dollars	21,981
Canadian dollars	514
Australian dollars	890
Japanese Yen	2,268
	<u>29,790</u>
Investment return for the year	£'000
United States dollars	
	25
Canadian dollars	1
Australian dollars	2
	<u>28</u>
Analysis of calendar year investment yield by fund	%
United States dollars	0.11
Canadian dollars	0.19
Australian dollars	0.22

The overall investment yield for 2016 was, £28k representing an average yield of 0.1% on average funds of £29.8m.

“Average funds” is the average of bank balances and overseas deposits held at the end of each month during the calendar year.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)**8. Financial Investments**

	Carrying value 2016 £000	Purchase price 2016 £000
Shares and other variable yield securities and units in unit trusts	22,460	22,460
	<u>22,460</u>	<u>22,460</u>

All “Shares and other variable yield securities and units in unit trusts” and “Debt securities and other fixed-income securities” are listed and are designated at fair value through profit or loss. These comprise 99.0% of the total market value of the Syndicate’s financial investments.

The following table shows financial instruments recorded at fair value analysed between the three levels in the fair value hierarchy.

31 December 2016	Level 1 £000	Level 2 £000	Level 3 £000	Total £000
Shares and other variable yield securities and units in unit trusts	22,460	-	-	22,460
	<u>22,460</u>	<u>-</u>	<u>-</u>	<u>22,460</u>

Included in the level 1 category are financial assets that are measured by reference to published quotes in an active market. A financial instrument is regarded as quoted in an active market if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency and those prices represent actual and regularly occurring market transactions on an arm’s length basis.

There are no level 2 category are financial assets measured using a valuation technique based on assumptions that are supported by prices from observable current market transactions.

There are no financial investments which fall into the level 3 category and there have been no transfers between fair value hierarchy categories during the year.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

9. Financial Instruments

A breakdown of how the Syndicate's financial instruments are measured is given below:

	2016
	£000
Financial assets at fair value through profit and loss	
Shares and other variable yield securities and units in unit trusts	
	<u>22,460</u>
Financial assets that are debt instruments measured at amortised cost	
Debtors arising out of reinsurance operations	
	<u>26,670</u>

10. Provisions for Unearned Premiums

2016	Gross £000	Reinsurer's share £000	Net £000
At 1 January 2016	-	-	-
Premiums written in the year	84,686	(20,565)	64,121
Premiums earned in the year	(49,516)	14,484	(35,032)
Foreign Exchange	2,751	(459)	2,292
At 31 December 2016	<u>37,921</u>	<u>(6,540)</u>	<u>31,381</u>

11. Claims Outstanding

2016	Gross £000	Reinsurer's share £000	Net £000
At 1 January 2016	-	-	-
Claims incurred in current accident year	32,301	(11,003)	21,298
Claims paid during the year	(4,283)	922	(3,361)
Foreign Exchange	2,142	(802)	1,340
At 31 December 2016	<u>30,160</u>	<u>(10,883)</u>	<u>19,277</u>

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

12. Cash at Bank and in Hand and Other Deposits

	2016 £000
Cash at bank and in hand	7,232
Other deposits	97
	<u>7,329</u>

Other deposits comprise overseas deposits which are lodged as a condition of conducting underwriting business in certain countries.

Together these balances comprise cash and cash equivalents presented in the Statement of Cash Flows.

13. Deferred Acquisition Costs

	2016 £000
At 1 January	-
Change in deferred acquisition costs	4 4,542
Foreign Exchange	(493)
At 31 December	<u>4,049</u>

Please see note 4 in reference to change in deferred acquisition costs.

14. Debtors arising out of reinsurance operations

	2016 £000
1955 Quota share reinsurance debtor	23,058
1856 Gross premium due	<u>3,612</u>
	<u>26,670</u>

The 1955 Quota Share Reinsurance debtor is the balance held with Syndicate 1955 and this includes underwriting and expenses ceded to Syndicate 1856.

15. Other Creditors

	2016 £000
Working Capital Loan – Humboldt Re	17 3,139
Working Capital Loan – Iris Balanced	17 4,196
Working Capital Loan – Iris Low	17 4,196
	<u>11,531</u>

The working capital loans are from Corporate Members and are payable on demand. Please see related party note 17 below.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

16. Risk Management

a. Governance Framework

The primary objective of the Agency's risk and financial management framework is to protect the members from events that hinder the sustainable achievement of financial performance objectives, including failing to exploit opportunities. Management recognises the critical importance of having efficient and effective risk management systems in place.

The Agency has established a risk management framework and has adopted the terms of reference of the Barbican Group's Risk Management function and approves the annual plans of that function to support its risk management framework. The risk management framework is supplemented with a clear organisational structure with documented delegated authorities and responsibilities from the Agency Board to the Managing Director and executive management committees. Lastly, a policy framework which sets out the risk profiles for the Syndicate, risk management, control and business conduct standards for the Syndicate's operations has been put in place.

The Agency Board approves risk management policies and meets regularly to approve any commercial, regulatory and organisational requirements of such policies relevant to the Syndicate and their implementation. These policies define the identification of risk and its interpretation to ensure the appropriate quality and diversification of assets, align underwriting and reinsurance strategy to the corporate goals, and specify reporting requirements. Significant emphasis is placed on the assessment and documentation of risks and controls, including the articulation of risk appetite.

b. Capital Management Objectives, Policies and Approach

In line with the Lloyd's capital framework, Lloyd's capital setting process and provision of capital by members, the Agency has established the following capital management objectives, policies and approach to managing the risks that affect the Syndicate's capital position:

- To maintain the required level of stability of the Syndicate thereby providing a degree of security to insureds;
- To allocate capital efficiently and support the development of business by ensuring that returns on capital employed meet the requirements of its capital providers and of its members;
- To retain financial flexibility by maintaining strong liquidity and access to a range of capital markets;
- To align the profile of assets and liabilities taking account of risks inherent in the business, and
- To maintain financial strength to support new business growth and to satisfy the requirements of the insureds, regulators and stakeholders.

The operations of the Agency, which manages the underwriting of the Syndicate, are subject to regulatory requirements within the jurisdictions in which it operates, in particular compliance with Financial Conduct Authority ("FCA") rules, Prudential Regulation Authority ("PRA") rules, the

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

16. Risk Management (continued)

b. Capital Management Objectives, Policies and Approach (continued)

Society of Lloyd's standards and byelaws, and relevant EU regulations and European Insurance and Occupational Pensions Authority ("EIOPA") guidelines. Such regulations not only prescribe approval and monitoring of activities, but also impose certain restrictive provisions (e.g., capital adequacy) to minimise the risk of default and insolvency on the part of insurers to meet unforeseen liabilities as they arise.

The Syndicate has met all of these requirements throughout the financial year.

In reporting financial strength, capital and solvency are principally measured using the rules prescribed by the PRA as applicable to the Society of Lloyd's and Lloyd's managing agents. These regulatory capital tests are based upon required levels of solvency, capital and a series of prudent assumptions in respect of the type of business written.

The Agency's capital management policy is to hold sufficient capital to cover the statutory requirements based on the requirements of the PRA and Lloyd's, including any additional amounts required by the regulators.

c. Approach to Capital Management

The Agency seeks to optimise the structure and sources of capital to ensure that it consistently maximises capital resources.

The Agency's approach to managing Syndicate capital involves managing assets, liabilities and risks in a coordinated way, assessing shortfalls between reported and required capital levels on a regular basis and taking appropriate actions to manage the capital position of the Syndicate in the light of changes in economic conditions and risk characteristics. An important aspect of the Syndicate's overall capital management process is the setting of target risk adjusted rates of return, which are aligned to performance objectives and ensure that the Syndicate is focused on the creation of value for members.

The primary sources of capital used by the Syndicate are members' balances and bank letters of credit.

The capital requirements are routinely forecast on a periodic basis and assessed against both the forecast available capital and the expected internal rate of return, including risk and sensitivity analyses. The process is ultimately subject to approval by the Agency Board.

The Agency has developed a Lloyd's Internal Model ("LIM") framework on behalf of the Syndicate to identify risks and quantify their impact on economic capital. The LIM estimates how much capital is required to reduce the risk of insolvency to a remote degree of probability under Solvency II requirements. The LIM has also been considered in assessing the capital requirement.

The Syndicate has had no significant changes in its policies and processes to its capital structure during the past year.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

16. Risk Management (continued)

d. Capital Resources Requirement

The Syndicate is subject to capital requirements imposed by Lloyd's. Throughout the year the Syndicate has complied with the Lloyd's risk based LIM methodology under Solvency II, which is used to calculate the Syndicate's capital requirement. Lloyd's capital setting use a capital requirement set at syndicate level as a starting point. The requirement to meet Solvency II & Lloyd's capital requirements apply at overall member level respectively, not at syndicate level. Accordingly, the capital requirement of Syndicate 1856 is not disclosed in these financial statements.

e. Solvency II Capital Requirements

Under the Solvency II regime, there are two prescribed methods for assessing an insurer's regulatory capital requirements – using either a standard formula set by the regulator or an Internal Model specific to that insurer which is subject to regulatory approval.

The Syndicate operates within the Lloyd's market. The PRA has determined that the Society of Lloyd's is the relevant insurer for the Lloyd's market. The Society of Lloyd's has chosen to operate an Internal Model and this was approved by the PRA in December 2015. The Society of Lloyd's require all managing agents to operate an internal model for each managed syndicate that is structured on Solvency II lines and which (when aggregated) ensures the integrity and effectiveness of the Society of Lloyd's Internal Model. The Solvency II regime became effective on 1 January 2016.

The Society of Lloyd's not only oversees the approval and monitoring of each syndicate's internal model, but also imposes certain restrictive provisions to minimise the risk of non-compliance with regulatory capital requirements.

The effective management of risk and capital is a key strategic priority. The Agency's risk management framework enhances the definition of the risk standards and risk tolerances which guide the day-to-day business decision making and processes and aim to ensure that the risk appetite is not exceeded.

Economic capital is calculated for the Syndicate considering the complete spectrum of risks identified by the risk framework, ensuring that the capital requirement reflects the risk profile and enabling capital to be allocated and returns measured on a risk adjusted basis.

The Solvency II Directive has been transposed into UK legislation through PRA rules and guidance. In addition, Solvency II firms are obligated to comply with relevant EU regulations and EIOPA guidelines. The PRA authorises and regulates both the Society of Lloyd's and Lloyd's managing agents, including the Agency. In addition, the Society of Lloyd's supervises certain activities performed by Lloyd's managing agents.

The Syndicate will submit its first Annual Solvency Return (ASR), for 31 December 2016 to Lloyd's on 6 April 2017.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

16. Risk Management (continued)

f. Insurance Risk

Insurance risk refers to fluctuations in the timing, frequency and severity of insured events, relative to the expectations of the Syndicate at the time of underwriting.

Some specific examples of insurance risk include variations in the severity or frequency of claims or the unexpected occurrence of multiple claims arising from a single cause. More generally, insurance risk includes the potential for claims overruns relative to pricing or reserving assumptions.

Insurance risk is a concern in a prudential context because inadequate systems and controls for its management can create a threat to the PRA's regulatory objectives of maintaining market confidence and consumer protection. Inadequately managed insurance risk may result in:

1. The inability of a syndicate to meet its contractual insurance liabilities as they fall due; and
2. The inability of a syndicate to treat its insureds fairly and consistently with the Syndicate's obligations.

The Syndicate's underwriting strategy is to write a book of business with a focus on building a composite portfolio with a high level of diversification, thus creating a business with low volatility and a good opportunity for consistent profit across the underwriting cycle. The Syndicate's appetite is governed by market conditions and management undertakes a continuous assessment of its portfolio against this background.

Tolerance - Risk Appetite

The Syndicate's tolerance by class of business is covered within the business plan. The Syndicate operated within defined exception criteria as follows:

1. Stamp capacity was £89.2m for the 2016 year of account;
2. Maximum realistic disaster scenario net exposure for the 2016 Year of Account of 20.5% of stamp capacity; and
3. Usual maximum gross line size for 2016 of £14.2m.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

16. Risk Management (continued)

f. Insurance Risk (continued)

Claims

Open market claims are settled by the claims management team. The claims department operates to approved claims handling guidelines which reflect Lloyd's minimum standards.

Claims development tables shown on an underwriting year basis and are set out below and the key assumptions underlying liability estimates are set out in the Key Assumptions section.

Gross insurance ultimate contract outstanding claims provisions as at 31 December 2016:

Underwriting Year	2016
Estimate of ultimate gross claims:	£000
At end of underwriting year	61,414
Current estimate of ultimate claims	61,414
Cumulative payments	(4,283)
Gross unearned claims reserve	(26,971)
Gross claims reserve	<u>30,160</u>

Net insurance ultimate contract outstanding claims provisions as at 31 December 2016:

Underwriting Year	2016
Estimate of ultimate net claims:	£000
At end of underwriting year	42,628
Current estimate of ultimate claims	42,628
Cumulative payments	(3,361)
Net unearned claims reserve	(19,990)
Net claims reserve	<u>19,277</u>

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

16. Risk Management (continued)

f. Insurance Risk (continued)

The claim liabilities are sensitive to the key assumptions that follow. It has not been possible to quantify the sensitivity of certain assumptions such as legislative changes or uncertainty in the estimation process.

The following analysis is performed for reasonably possible movements in key assumptions with all other assumptions held constant, showing the impact on gross and net liabilities, profit before tax and members' balances.

31 December 2016	Change in assumptions	Impact on gross liabilities £000	Impact on net liabilities £000	Impact on profit and members' balances £000
Average claim cost	+10%	2,986	1,630	(1,630)
Average number of claims	+10%	2,986	1,880	(1,880)

The Agency uses both its own and commercially available proprietary risk management software to assess Syndicate catastrophe exposure. However, there is always a risk that the assumptions and techniques used in these models are unreliable or that claims arising from an un-modelled event are greater than those arising from a modelled event.

The following table shows hypothetical claims arising for the largest realistic disaster scenarios based on the Syndicate's average risk exposures during 2016.

	Estimated gross loss \$m	Estimated net loss \$m
US earthquake	57	27
US windstorm	94	25
Japan earthquake	33	24
Japan windstorm	17	17
Europe windstorm	46	25
	<u>247</u>	<u>118</u>

There are agreed documented outwards reinsurance procedures in place covering the purchase of reinsurance and the procedures for making recoveries. There is also a policy for the approval of reinsurers to minimise credit risk.

The Agency assesses the Syndicate's need for reinsurance on a continuous basis. The structure of the reinsurance programme is part of the annual planning process and broad estimates of reinsurance spend are made. The programme is subject to extension or modification as the year progresses. Procedures for purchasing approval and transactions processing are set out in a procedures manual.

The table below sets out the concentration of outstanding claim liabilities by business segment:

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)**16. Risk Management (continued)****f. Insurance Risk (continued)**

31 December 2016	Gross liabilities £000	Reinsurance assets £000	Net liabilities £000
Reinsurance	(30,160)	10,833	(19,277)
Total	(30,160)	10,883	(19,277)

The geographical concentration of the outstanding claim liabilities is noted below. The disclosure is based on the countries where business is written. The analysis would not be materially different if based on the countries in which the counterparties are situated.

31 December 2016	Gross liabilities £000	Reinsurance assets £000	Net liabilities £000
United Kingdom	(4,662)	1,682	(2,980)
EEA	(2,223)	802	(1,421)
USA	(18,700)	6,747	(11,953)
International	(4,575)	1,652	(2,923)
Total	(30,160)	10,883	(19,277)

Key Assumptions

The principal assumption underlying the liability estimates is that the future claims development will follow a similar pattern to past claims development experience. This includes assumptions in respect of average claim costs, claim handling costs, claim inflation factors and claim numbers for each accident year. Additional qualitative judgements are used to assess the extent to which past trends may not apply in the future, for example: one-off occurrence; changes in market factors such as public attitude to claiming; economic conditions and internal factors such as portfolio mix, policy conditions and claims handling procedures. Judgement is further used to assess the extent to which external factors such as judicial decisions and government legislation affect the estimates.

Other key circumstances affecting the reliability of assumptions include variation in interest rates, delays in settlement and changes in foreign currency rates.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

16. Risk Management (continued)

g. Credit Risk

Credit risk arises where one party is exposed to a loss through another party failing to perform its financial obligations to the other party, including failure to perform in a timely manner. Examples of credit risk arising in insurance are from premium debtors, where cover under contracts of insurance may either commence before premiums become due or continue after their non-payment. It can also arise if a reinsurer fails to fulfil its obligation to pay where a valid claim has been made.

Credit risk is not limited to those risks arising in insurance but also in financial investments where the Syndicate is exposed to potential failure by investment counterparties.

Credit risk is a concern in a prudential context because of the risk of erosion of capital due to persistent credit losses so threatening its viability as a going concern and hampering the Syndicate's ability to meet its own obligations to its insureds.

The Agency has adopted a prudent investment policy. Exposure to investment counterparty risk has been minimised by appointing experienced third party investment managers and operating to agreed investment guidelines which determine the investments to which the Syndicate is exposed. Investments performance is overseen by the Investment Committee.

The overall responsibility for the oversight of intermediaries and reinsurers has been delegated to the Risk Capital Committee. The Risk Capital Committee reviews the credit ratings of reinsurers on a quarterly basis and reports to the Agency Board's, which approves the use of intermediaries and reinsurers and reviews any late settlement or reputational issues of the counterparties. The finance and compliance functions support the formation and renewal of intermediary relationships to help ensure that inappropriate parties are not used by the Syndicate. The policy for approving reinsurers includes limits on counterparty exposure in order to limit the total credit risk the Syndicate may be exposed to in respect of any one reinsurer.

Credit risk from exposure to investment counterparties is controlled by operating to very prudent investment guidelines. Investments are managed by a third party investment manager, appointed under the terms of an Investment Management Agreement. The Syndicate's maximum exposure to credit risk to the assets below at 31 December 2016 is the carrying amount as presented in the note.

A ratings table for the Syndicate's financial assets is given below.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)**16. Risk Management (continued)****g. Credit Risk (continued)**

	AAA £000	AA £000	A and Below £000	Unrated £000	Total £000
Current Year					
Financial Investments	-	-	-	22,460	22,460
Cash at bank and in hand	-	-	-	7,232	7,232
Overseas deposits	-	-	-	97	97
Reinsurer' share of claims outstanding	-	2,420	3,626	1,331	7,377
Debtors arising out of reinsurance operations	-	-	26,670	-	26,670
Total	-	2,420	30,296	31,120	63,836

The source for ratings is Standard and Poor's.

The Syndicate does not consider that there is a significant concentration of risk with respect to its insurance receivables accounts. Of the total assets, none have been impaired.

The ageing of the Syndicate's assets is disclosed below:

At 31 December 2016	Neither due nor impaired £000	Up to three months £000	Three to six months £000	Six months to one year £000	Greater than one year £000	Total £000
Financial investments	22,460	-	-	-	-	22,460
Overseas Deposits	97	-	-	-	-	97
Cash at bank and in hand	7,232	-	-	-	-	7,232
Reinsurer' share of claims outstanding	7,377	3,475	30	-	-	10,883
Other debtors	28,942	8,517	75	-	-	37,533
Total	66,108	11,992	105	-	-	78,205

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

16. Risk Management (continued)

h. Market Risk

Market risk is defined as the risk or uncertainty arising from possible market price movements and their impact on the future performance of a business. This includes the possibility that changes in market factors, foreign currency exchange rates or interest rates will adversely affect the value of the Syndicate's financial assets, liabilities or expected future cash flows.

The intention of the Agency is for the Syndicate to invest surplus funds in low risk securities in line with the agreed investment guidelines.

i. Foreign Currency Risk

In order to minimise market risk arising from foreign exchange the Syndicate matches the currency of anticipated liabilities to its assets. Shortfalls of sterling to settle expenses are managed by the sale of surplus currencies as required.

Cash flow reports form part of monthly accounting. Cash flow forecasts are performed regularly to ensure currencies are matched and to minimise any foreign exchange risk.

The Syndicate maintains ledger balances in six main currencies: Sterling, Euros, US Dollars, Japanese Yen, Australian Dollars and Canadian Dollars. The most important non-sterling currency exposure relates to the US dollar. As well as the US Situs business, exposures arise from a number of classes of business transacted outside of the USA, mainly Property. Maintenance of currency ledgers enables the Agency to monitor foreign exchange risk.

The carrying value of total assets and liabilities by currency is as follows:

At 31 December 2016	GBP £000	US \$ £000	Euro € £000	CAD \$ £000	Other £000	Total £000
Reinsurance assets	1,852	15,366	146	(15)	74	17,423
Insurance receivables	(2,136)	25,342	1,541	60	1,863	26,670
Financial Investments	-	21,980	-	480	-	22,460
Cash and cash equivalents	904		3,232	-	3,096	7,232
Other Assets	(2,306)	6,632	47	(149)	197	4,421
Total assets	(1,686)	69,320	4,966	376	5,230	78,206
Technical Provisions	(3,917)	(53,964)	(5,137)	(1,633)	(3,430)	(68,081)
Other creditors	(3,060)	(8,546)	-	-	-	(11,606)
Total Liabilities	(6,977)	(62,510)	(5,137)	(1,633)	(3,430)	(79,687)
Currency Adjustments	3,226	(3,409)		183		0
Members' balances	(5,437)	3,401	(171)	(1,440)	1,800	1,481

The Syndicate has sufficient free funds available in other currencies, which can be translated at any point to cover expenses payable and any other liabilities incurred.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

16. Risk Management (continued)

j. Interest Rate Risk (continued)

The Syndicate holds financial assets that are exposed to interest rate risk. Changes in interest yields, with all other variables constant, would result in changes in the capital value of financial investments and cash. This would affect reported profits and members' balances as indicated in the stress test below. This is applied to the position as at 31 December 2016 and takes into account the full effect of mark to market movements, but without recognising any running yield benefit.

Increase/(decrease) on members' balances

2016

£000

Strengthening of US dollar

(180)

Weakening of US dollar

241

Strengthening of Euro

6

Weakening of Euro

(7)

Impact on loss for the year

Impact on members' balances

2016

2016

£000

£000

Shift in yield (basis points)

50 basis points decrease

10

10

50 basis points increase

(10)

(10)

16. Risk Management (continued)

k. Liquidity Risk

Liquidity risk is the risk that a Syndicate, although solvent, either does not have available sufficient financial resources to enable it to meet its obligations as they fall due, or can secure such resources only at excessive cost. The Agency's liquidity risk policy covers only those aspects of liquidity risk which do not fall under the heading of insurance risks. Broadly, it is the management of risk arising from short-term cash-flows, rather than the risk arising from longer term matching of assets and liabilities. Nevertheless, it covers the risk of shock loss events and the risk of having insufficient liquid funds to settle liabilities.

Liquidity risk arises if assets prove to be worth substantially less than anticipated when they have to be realised i.e. there is a mismatch between planning to realise assets and actual events. Liquidity risk is closely related to market and credit risks though these are covered by separate risk policies. Market risk arises where the value of the fund/investments proves to be significantly less than anticipated due to deterioration/flux in the general economy or from currency exchange rate movement. The credit risk policy seeks to ensure that the Syndicate is in a position to meet all payments as they fall due by ensuring that inwards funds are paid promptly.

Additionally, the Syndicate aims to maintain minimum and maximum amounts of its investments in liquid funds and/or cash and cash equivalents.

The credit risk policy covers key reinsurance contracts into which the Syndicate enters, with details given below of complex reinsurance arrangements:

Future Cash Flows

A summary of the statement of financial position showing the expected timing of future cash flows is shown below.

At 31 December 2016	< 1 year £000	1-3 years £000	3-5 years £000	> 5years £000	Total £000
Claims outstanding	30,160	-	-	-	30,160
Other Creditors	11,531	-	-	-	11,531
Total Liabilities	41,691	-	-	-	41,691

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

16. Risk Management (continued)

l. Operational Risk

Operational risk is the risk of loss, resulting from inadequate or failed internal processes, people and systems, or from external events. Operational risk is inclusive of all internal processes, manual and computerised, and all systems; internal and external fraud; and employee competence. Employee relations and culture are included in people risks.

An assessment of operational risk is important as it can affect a Syndicate's solvency, or lead to unfair treatment of consumers or lead to financial crime. The Syndicate should consider all operational risk events that may affect these matters in establishing and maintaining its systems and controls.

The Agency's strategy is to implement and maintain a high level of operational processes and procedures. These are subject to ongoing review and update. This will help reduce and control operational risk more effectively and make any subsequent loss more manageable. The operational controls are designed to meet the requirements of relevant regulatory bodies and agreed best practice. All operational controls are monitored on a regular basis to ensure that they remain fit for purpose.

m. Dependencies between Risk Categories

Under certain conditions, the outcome with respect to one risk category could influence the outcome of another. There are two such specific dependencies which the Agency has identified:

1. A major loss event could lead to widespread failures within the reinsurance market. The loss would need to be very large since the reinsurance market, particularly that part of the market to which the Syndicate is exposed, has in the past shown itself to be robust enough to withstand losses such as World Trade Center and major hurricane losses.
2. There are a number of operational risks that have the potential to correlate with major natural catastrophe losses. For example, the consequences of inadequately monitoring liquidity are only likely to be suffered should there be a significant call on liquidity (likely to happen after a major loss event).

Major loss events may have an effect on investment markets; however, the effect tends to be felt principally in equity markets to which the Syndicate has no current direct exposure.

In terms of other loss types, an aggregation of casualty claims might coincide with a weak economy. Historically, although more commonly a weak economy has coincided with a period of lower interest rates, this relationship varies depending upon the cause of the weak economy and in some instances can be accompanied by higher interest rates. The timing of the claims experience is also far from clear; in some instances, recessionary claims emerge with clarity only with a sufficient time lag (even under claims-made cover) such that the economy is improving again and interest rates might be rising. Therefore, although there is an argument for some degree of positive correlation, it is not clear how significant this might be.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

17. Related parties

Whole Account 1955 Quota Share

On 1 January 2016, Arcus Syndicate 1856, managed by the Agency, commenced trading. Syndicate 1955 ceded £44.5m of premium to Syndicate 1856 for the 2016 Year of Account. This is on the basis of a 15.4% cession of all classes of business.

The balance with Syndicate 1955 as at 31st December 2016 is £23m.

Barbican Managing Agency Limited

The balance with BMAL as at 31st December 2016 is Nil; this is due to the Syndicate settling the amount of £3.3m in December for the recharges due for 2016.

Working Capital Loans

In January 2016 and late December 2016 Arcus Syndicate 1856 received working capital loans from the Syndicate's Corporate Members. The loans are payable on demand and details of the loans are outlined below.

	Date of Loans	Currency Received	Interest per Annum %	Interest Charged	Loan In Currency '000	CNV Sterling £000
IRIS Low Volatility Plus Corporate Member Limited	Jan-16	GBP	2.25%	33	1,492	1,492
IRIS Balanced Corporate Member Limited	Jan-16	GBP	2.25%	33	1,492	1,492
Humboldt Corporate Member Limited	Jan-16	USD	2.25%	28	1,562	1,288
IRIS Low Volatility Plus Corporate Member Limited	Dec-16	USD	2.25%		2,295	1,851
IRIS Balanced Corporate Member Limited	Dec-16	USD	2.25%		3,353	2,704
Humboldt Corporate Member Limited	Dec-16	USD	2.25%		3,353	2,704
				94	13,547	11,531

Key Management Personnel Compensation

The key management personnel are deemed to be the Directors of the Agency.

The Directors' remuneration has been disclosed separately in note 6 to the financial statements.

18. Funds at Lloyd's

Every member of Lloyd's is required to hold capital at Lloyd's which is held in trust and known as Funds at Lloyd's (FAL). These funds are intended primarily to cover circumstances where Syndicate assets prove insufficient to meet participating members' underwriting liabilities.

The level of FAL that Lloyd's requires a member to maintain is determined by Lloyd's based on PRA requirements and resource criteria. FAL has regard to a number of factors including the nature and amount of risk to be underwritten by the member and the assessment of the reserving risk in respect of business that has been underwritten. Since FAL is not under the management of the Agency or the Syndicate, no amount has been shown in these Annual Accounts by way of such capital resources. However, the Agency is able to make a call on the members' FAL to meet liquidity requirements or to settle losses.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

19. Off-statement of financial position items

The Syndicate has not been party to any arrangement, not reflected in its statement of financial position, where material risks or benefits arise for the Syndicate.

20. Derivatives

The Syndicate has not purchased any forward foreign currency contracts to hedge currency exposure or entered into any other derivative contracts within the period.

21. Post Reporting Date Events

There are no post statement of financial position events which will impact the Syndicate's 2016 result or financial position.