Market Results

Challenging underwriting and investment market conditions and significant losses from natural catastrophes have impacted the Lloyd's market result. It is in these moments that Lloyd's proves its value and strength, being able to more than meet its substantial commitments without any significant impact on its total resources.

Lloyd's has lived up to its centuries old promise and purpose – to be there when it matters most, providing the financial support to enable businesses, governments and most importantly people, to recover and rebuild their lives as quickly as possible.

Contents

2018 Highlights

Financial highlights

— Lloyd's reported a loss of £1,001m (2017: a loss of £2,001m)
— Combined ratio of 104.5% (2017: 114.0%)
— Gross written premium of £35,527m (2017: £33,591m)
— Capital, reserves and subordinated loan notes stand at £28,222m (2017: £27,560m)

Gross written premium (£m)

2014	25,259
2015	26,690
2016	29,862
2017	33,591
2018	**35,527**

Result before tax (£m)

2014	3,016
2015	2,122
2016	2,107
2017	(2,001)
2018	**(1,001)**

Capital, reserves and subordinated debt and securities (£m)

2014	23,413
2015	25,098
2016	28,597
2017	27,560
2018	**28,222**

Central assets (£m)

2014	2,578
2015	2,645
2016	2,879
2017	2,981
2018	**3,211**

Return on capital* (%)

2014	14.1
2015	9.1
2016	8.1
2017	(7.3)
2018	**(3.7)**

Combined ratio* (%)

2014	88.4
2015	90.0
2016	97.9
2017	114.0
2018	**104.5**

The Pro Forma Financial Statements (PFFS) are prepared so that the financial results of Lloyd's and its members taken together and their net assets can be compared as closely as possible with general insurance companies. The PFFS include the aggregate of syndicate annual accounts (Aggregate Accounts), members' funds at Lloyd's (FAL) and the Society of Lloyd's financial statements. Further information concerning the basis of preparation of the PFFS is set out on pages 42-43.

* The return on capital and the combined ratio are metrics that are consistently used to analyse financial performance in the Lloyd's market results and/or in the Society Report. These metrics (wherever used in this Annual Report) are Alternative Performance Measures (APMs), with further information available on page 184.

The Lloyd's market reported a pre-tax loss of £1,001m in 2018 (2017: a loss of £2,001m) and a combined ratio of 104.5% (2017: 114.0%). This result is driven by the losses arising from a number of catastrophic events which impacted the insurance industry in the second half of 2018, notably Hurricanes Florence and Michael and the wildfires in California. 2018 was the second successive year of significant catastrophic losses for the insurance industry and so too for the Lloyd's market. Insured losses arising from catastrophic events cost the Lloyd's market £2.9bn, net of reinsurance, in 2018 (2017: £4.6bn) and added 11.6% to the combined ratio (2017: 18.5%). The impact of these major events on the Lloyd's market result was offset to some extent by prior year releases of £976m (2017: £706m), representing a 3.9% (2017: 2.9%) improvement to the combined ratio.

During 2018 stable or increased pricing levels became more widespread as the year progressed after many years of decline; favourable price movements were seen across all lines of business and more notably in those which had the greatest exposures to the major catastrophic events in 2017. The Lloyd's market experienced a weighted average increase in prices on renewal business slightly over 3% in 2018. In addition, several syndicates exited or severely curbed their risk appetites in poor-performing lines, as Lloyd's began to ramp up its activity to support the market in closing the performance gap.

There has been a small reduction in the operating expense ratio in 2018 reflecting the initial effects of actions being taken by Lloyd's and the market to reduce the cost of doing business; the operating expense ratio is 39.2%, down from 39.5% in 2017. Reducing the Lloyd's market expenses will continue to be an area of focus in 2019.

Investment return was £504m (2017: £1,800m), a return of 0.7% (2017: 2.7%), reflecting the challenging year in the financial markets, with most risk assets generating negative returns as equity markets in particular suffered in the fourth quarter.

Foreign exchange had a negligible impact on the result with a small loss reported in 2018. This reflected the impact of most major currencies strengthening against sterling in 2018. The increase in other expenses is primarily driven by the costs associated with establishing the Lloyd's Brussels subsidiary.

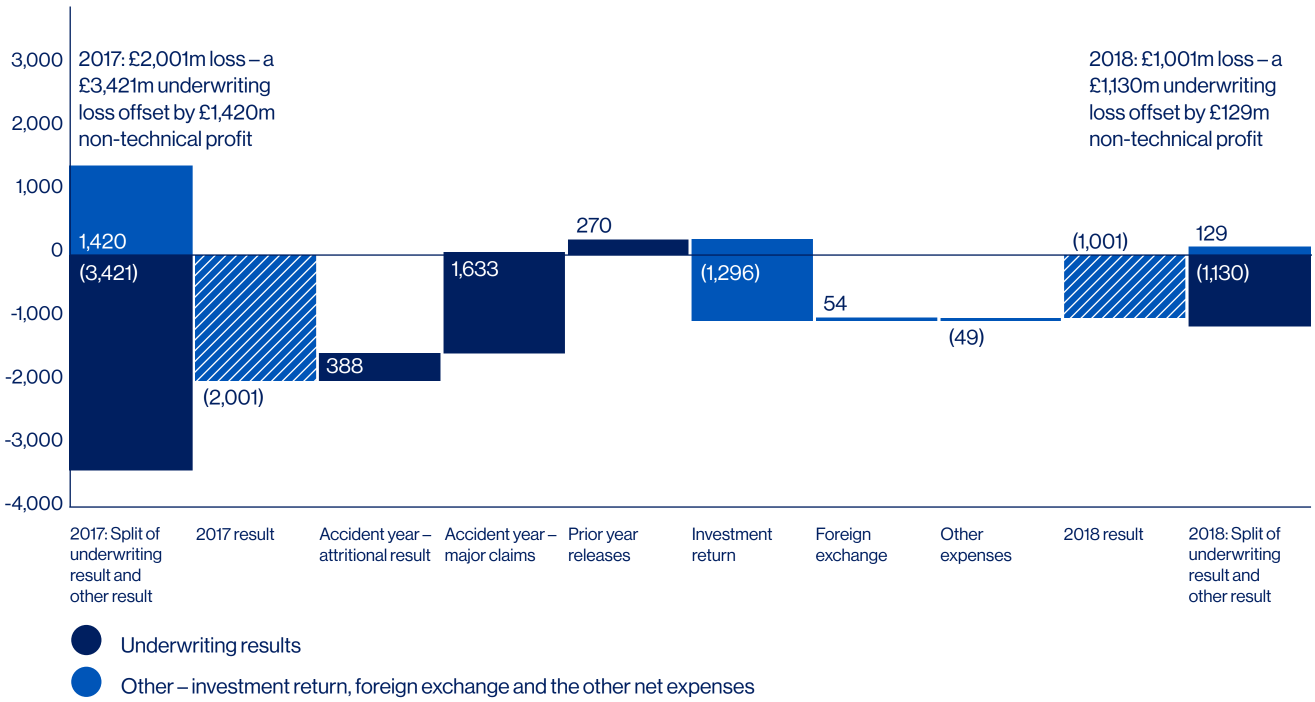
The Pro Forma Financial Statements (PFFS) aggregates the results of the syndicate annual accounts, notional investment return on members' funds at Lloyd's and the Society's financial statements. The basis of preparation of the PFFS is set out in note 2 on pages 42 to 43.

Looking ahead

The 2019 planning cycle was the most challenging, so far, for the Lloyd's market with the significant level of effort placed on remediation activities against poor-performing lines of business and syndicates as part of the drive to close the performance gap. There are already some encouraging signs in 2019 that the remedial action being taken is gaining traction; there is a greater level of focus on underwriting controls, the correct pricing of attritional, large and catastrophe exposures and acquisition and administrative expenses.

While industry capital remains stable at an all-time high, with plenty more still potentially available, this is likely to continue acting as a constraint to the scale of improvement that is necessary. Notwithstanding another costly year in terms of natural catastrophes (with latest industry insured loss estimates as high as US$79bn), market conditions look set to remain broadly stable. Increased prices are likely to be confined to specific risks and regions impacted by losses from these events.

Drivers of market result – change from 2017 to 2018 (£m)



2018 Highlights *continued*

The macroeconomic environment remains challenging with the parlous state of world politics and fragile global economic climate requiring careful monitoring and a nimble, and pro-active, underwriting response. Aside from the conundrum posed by Brexit, increasing global protectionism and continued violent extremism remain key topics to watch.

2018 performance

Gross written premium for the year increased to £35,527m compared with £33,591m in 2017. US dollar denominated business continues to account for the largest share of business at Lloyd's. The average exchange rate in 2018 was US$1.34: £1 compared with US$1.29: £1 in 2017. The US dollar and other currency movements have decreased premiums as reported in converted sterling by 4%. Adjusting for the impact of exchange rate movements, the increase in gross written premium was 10%.

The overall price change (taking into account terms and conditions) on renewal business was an increase of approximately 3%, which was slightly above planning assumptions for the year. This increase was largely driven by catastrophe impacted lines. During the year, there continued to be growth in most lines, although the rate of growth slowed throughout the year. The main exception was aviation where further contraction was evident.

The underlying accident year ratio, excluding major claims, was 96.8% (2017: 98.4%) which reflects the small improvement in risk adjusted pricing since 2017. However, underlying claims inflation, deductible erosion, current pricing and terms and conditions continue to contribute to high attritional loss levels, albeit the attritional ratio has improved by 1.3% in 2018.

Major claims

Major claims for the market were £2,906m in 2018 (2017: £4,539m), net of reinsurance and including reinstatements payable and receivable. Total industry insured losses for the catastrophe events of 2018 are estimated to be US$79bn.

After a long period of relatively benign major loss activity pre-2017, the cost of major claims to the Lloyd's market in 2018 is the fourth highest since 2003, in today's terms. This continued period of high losses follows on from 2017, which was the third highest year for losses over that period.

The largest insured natural catastrophe event was Hurricane Michael. This event, which devastated large parts of Florida, was the second of two large hurricanes to hit the US in the second half of 2018. The other large hurricane was Hurricane Florence, which caused significant wind and flood damage in North and South Carolina.

The market once again incurred significant claims from wildfires in California in November. Other notable events included a volcanic eruption in Hawaii in May, Typhoons Jebi and Mangkhut striking Asia in August and September, and losses resulting from a fire at the Lürssen shipyard in Germany in September.

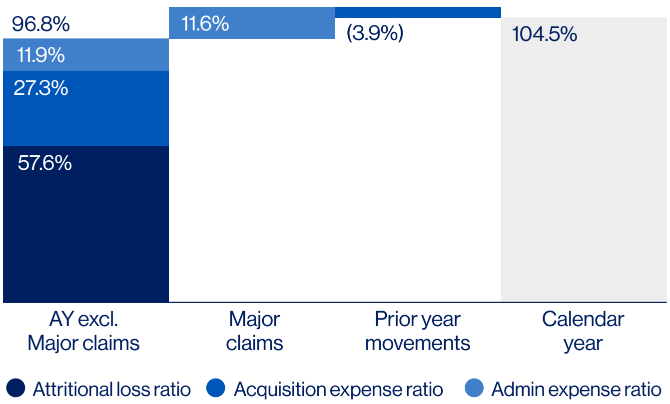
Major claims	% of net earned premium
2014	3.4
2015	3.5
2016	9.1
2017	18.5
2018	**11.6**
Five year average[1]	8.2
Ten year average[1]	10.2

Accident year ratio excl. major claims	%
2014	93.1
2015	94.4
2016	93.9
2017	98.4
2018	**96.8**
Five year average[1]	95.5
Ten year average[1]	92.4

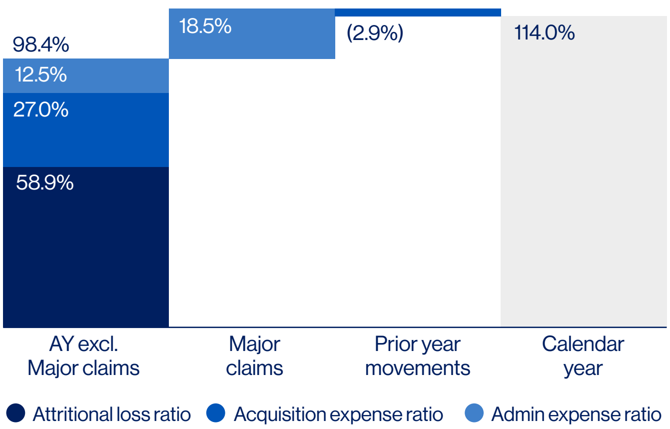
1. Weighted by net earned premium.

Contributors to combined ratio

2018 Combined ratio %



2017 Combined ratio %



Prior year movement

The combined ratio has been improved by 3.9% (2017: 2.9%) through prior year releases. The release represents 2.5% (2017: 1.9%) of net claims reserves brought forward at 1 January.

This was the 14th successive year of prior year releases. In each of these years, the level of release has been significantly influenced by actual experience. In 2018, aggregate attritional claims emergence was broadly in line with projected levels at a strict best estimate with releases from initial prudent claims estimates. The level of release is influenced by both claims experience and the reserving approach of the market.

With regard to the reserving approach, a number of managing agents adopt prudent initial held reserves. In the absence of poor claims experience these would be expected to result in future releases.

Estimates for major catastrophe events from recent years have also proved to be adequate, with only small movements in estimates seen during 2018.

In 2019, Lloyd's will continue to monitor reserves closely and act to ensure that adequate market discipline is being maintained in current challenging market conditions, particularly on the longer-tailed lines, such as casualty where there has been continued focus in recent years.

The actual level of claims payments ultimately made compared with the provisions held is an area of inherent uncertainty. Oversight of this area is a key focus for Lloyd's to ensure that the processes underlying these estimates are robust, provisions are adequate, and any release of provision is appropriate.

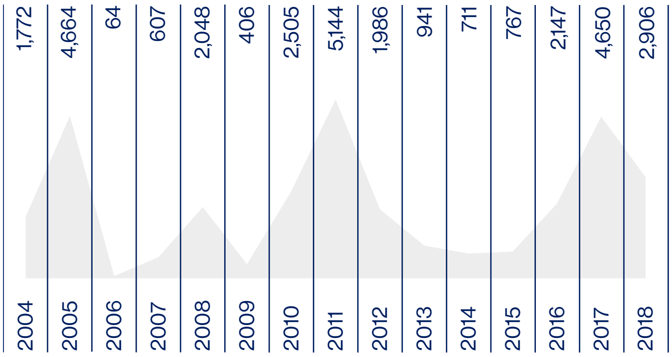
Reinsurance protection

The credit quality of the Lloyd's market's reinsurance protections remains extremely high, with 98% of all recoveries and reinsurance premium ceded being with reinsurers rated "A-" and above or supported by high quality collateral assets.

Reinsurers' share of claims outstanding remains a material consideration for Lloyd's (equivalent to 55% of gross written premium/78% of members' assets). There has been an increase in the overall reinsurance recoverables due to the catastrophe losses experienced in the second half of 2018. This increase reflects the reinsurance risk transfer strategy of the Lloyd's market and the nature of loss events experienced during 2017 and 2018. No negative settlement trends have been witnessed to date. Lloyd's will be monitoring this closely in 2019 as part of our normal market oversight procedures.

Lloyd's outward reinsurance premium spend for 2018 was 28% (2017: 26%) of gross written premium, which reflects a small increase in the scale of reinsurance purchased. This level of reinsurance transfer remains within risk appetite.

Lloyd's major losses: net ultimate claims (£m)



Five year average: £1,843m; 15 year average: £1,907m. Indexed for inflation to 2018. Claims in foreign currency translated at the exchange rates prevailing at the date of loss.

Prior year reserve movement	% of net earned premium
2014	(8.1)
2015	(7.9)
2016	(5.1)
2017	(2.9)
2018	**(3.9)**

Years of account in run-off	Number of years
2014	4
2015	4
2016	6
2017	5
2018	**0**

Result for the closed year and run-off years of account

Under Lloyd's three-year accounting policy for final distribution of each underwriting year of account, the 2016 account reached closure at 31 December 2018. 2016 witnessed some above average risk losses, notably in the property sector. Hurricane Matthew was the first category five hurricane since 2007 and impacted the Caribbean and the US. The Fort McMurray wildfire also devastated parts of Alberta, Canada. As a result, the 2016 pure year of account reported an underwriting loss. The 2016 pure year loss was offset partially by the addition of releases from prior years totalling £896m on the 2015 and prior reinsurance to close (RITC) (2014 and prior: £919m), which meant the year closed with an overall loss of £855m (2015 pure year profit: £1,620m).

Five years of account were in run-off at the beginning of 2018. All of these run-off years have now closed at the end of 2018, which represents a first for Lloyd's in recent years to have no open run-off years in existence.

In aggregate, run-off years reported a surplus of £7m including investment return (2017: surplus of £8m).

The results of the major lines of business are discussed in detail on pages 28-35.

Investment review

Equity and other risk assets endured a difficult year after a strong investment return in 2017. In 2018, financial markets suffered a volatile risk-off move in the last quarter of the year brought on by trade disputes, fears of a global slowdown, geopolitical risks and less accommodative financial conditions.

Developed market monetary policy continued to be tightened with central banks in the US, Canada and UK raising interest rates. However, core government bonds outperformed over the risk-off move in the fourth quarter. Credit spreads on corporate bond investments widened in line with the general risk-off sentiment.

The market's investments generated a return of £504m (2017: £1,800m), or 0.7% (2017: 2.7%), a significant reduction on the previous year and also well below the five-year average. In terms of key drivers, an allocation, albeit conservative, to equity and risk assets generated losses for the year, but this was offset by positive returns in cash, government and investment grade corporate bonds.

Syndicate premium trust fund assets form the largest element of investment assets at Lloyd's. Managing agents have responsibility for the investment of these assets, which are used to meet insurance claims as they become payable. The aggregate asset disposition reflects the balanced but conservative investment policy pursued by agents. Cash and high quality, shorter duration, fixed interest investments constitute a majority core share while return seeking equity and growth assets account for a moderate allocation at less than 10%.

Overall, syndicate investments returned £333m, or 0.8% in 2018 (2017: £907m, 2.2%). Investment return was materially lower this year driven by disappointing corporate bond returns as well as negative performance in equity and growth assets. Investments are valued at mark to market prices and unrealised gains and losses are included within reported investment returns.

Members' capital is generally held centrally at Lloyd's. A proportion of this capital is maintained in investment assets and managed at members' discretion. A notional investment return on members' capital of £178m, or 0.7% (2017: £722m, 3.1%) has been included in the Pro Forma Financial Statements (PFFS). This is based on the investment disposition of the relevant assets and market index returns. Return on this pool of assets was low by comparison with previous years with its allocation to equity and growth assets driving investment losses.

The investment return on Lloyd's central assets is also included in the PFFS. This was a loss of £7m or -0.2% in 2018 (2017: gain of £171m, 5.0%). The investment performance of central assets is discussed on pages 109-110.

Line of business: Reinsurance – Property

Property catastrophe excess of loss represents the largest sector in this line. Other key sectors are property facultative, property risk excess, property pro rata and agriculture and hail.

2018 performance

Lloyd's gross written premium for 2018 was £6,440m (2017: £5,991m), an increase of 7.5%. Growth was driven by improved pricing adequacy on property treaty and facultative contracts, albeit moderated by whether they were significantly loss impacted or not from 2017 events. The Lloyd's reinsurance property line reported an accident year ratio of 121.1% (2017: 134.3%).

2018 was another year in which globally, natural disasters at times dominated the headlines. Many of these events resulted in meaningful losses to the insurance market and while in aggregate not to the same scale of 2017, they remain above the long-term averages.

Prior year movement

The prior year movement was a release of 4.9% (2017: 4.0%). This line of business has seen releases across several prior years during 2018. In particular, there has been a large release on the 2016 year of account driven by reductions on the US property catastrophe losses compared to the estimates at the end of 2017, mainly due to the 2016 and 2017 US windstorm events. Movements are expected for historical catastrophe events, as there is greater certainty as claims are paid out.

Looking ahead

Despite a second year globally of above average natural catastrophe losses in 2018, there remains a surplus of capacity in the market. Anecdotal evidence suggests that pricing levels at January 2019 were generally below those expected by the market, but again this was dependent on region and whether or not the business was loss affected. Pricing adequacy may improve as 2019 progresses, with more loss impacted business renewing.

Reinsurance – Casualty

The largest sectors of the casualty treaty market at Lloyd's are non-marine liability excess of loss and US workers' compensation.

2018 performance

Lloyd's gross written premium for 2018 was £2,541m (2017: £2,223m), an increase of 14.3%. The Lloyd's reinsurance casualty line reported an accident year ratio of 99.7% (2017: 103.9%).

While the wider casualty treaty market has remained competitive, with an abundance of capacity, the underlying motor portfolios have seen sizeable rate strengthening in response to the change in Ogden discount rate in February 2017. As most treaty business renews at the start of the calendar year, syndicates were not able to react until 2018 renewals. In addition, prior to the Motor Insurers' Bureau announcing changes to how terrorism would be dealt with within motor policies, there has been considerable uncertainty within the UK motor treaty market with participants cutting back and restructuring of attachments and limits.

Prior year movement

The prior year movement was a release of 3.6% (2017: 1.8%). 2018 has been a year of relatively benign prior year claims experience for this line, leading to an overall reserve release. There has been overall deterioration seen for US casualty treaty business, however overall experience for the class has been favourable. Lloyd's continues to monitor these lines, as per the casualty class of business, to ensure adequate provisions remain over all prior years.

Looking ahead

Following the increasing severity of claim awards in the US, Canada and Australia in particular, there are signs that the market is starting to tighten capacity and there is likely to be further rate strengthening across all lines. Currently, these increases are unlikely to be sufficient to keep up with claims inflation, but it appears that greater scrutiny is being undertaken during renewal negotiations.

2018 combined ratio by line of business

	Accident year	Prior year reserve movement	Calendar year
Reinsurance	111.8%	(5.8%)	106.0%
Property	114.0%	(3.6%)	110.4%
Casualty	103.9%	(1.0%)	102.9%
Marine	115.6%	0.4%	116.0%
Energy	105.6%	(18.2%)	87.4%
Motor	101.8%	(3.1%)	98.7%
Aviation	119.8%	(7.8%)	112.0%
Life	98.6%	(20.8%)	77.8%

Reinsurance – Specialty

Marine reinsurance is the largest sector of the Lloyd's specialty reinsurance business, followed by energy and aviation.

2018 performance

Gross written premium overall was £2,089m (2017: £2,346m), a reduction of 11.0%. Gross written premium by sector within this specialty business was: Marine £1,090m (2017: £1,166m), Energy £624m (2017: £749m), Aviation £361m (2017: £415m) and Life £14m (2017: £16m). The Lloyd's reinsurance specialty line reported an accident year ratio of 101.9% (2017: 110.3%).

Marine excess of loss reinsurers were enjoying a relatively benign year with Hurricane Michael and Typhoon Jebi being less impactful than may have been expected. This changed following the Lürssen shipyard loss, which had substantial reinsurance coverage, having significant impact on the line.

While the year started off with positive pricing movements, this tailed off somewhat towards the end of the year, reflective of the high level of capacity available in the market.

Prior year movement

The prior year movement was a release of 11.0% (2017: 8.5%). The claims experience for this line has been favourable compared to expectations over the 2018 year. This line is predominantly marine, aviation and motor business, written on an excess of loss basis. Given that claims experience is largely driven by isolated claim events, prudent reserves tend to be held and released in years with less claims activity. In addition to the general release of prudence over time, the marine line is also impacted by the 2016 and 2017 US windstorm events, which have seen a reduction in the anticipated losses when compared to the estimates set at the end of 2017.

Looking ahead

There is some anecdotal evidence of price strengthening in the sector in 2019 following the effects of late 2018, which further compounded the hurricane-affected 2017 result. There may also be additional impetus following Lloyd's performance improvement planning – the effects of which may be felt beyond the classes immediately included in that review.

Property

The property line consists of a broad range of risks written worldwide. It is made up of predominantly excess and surplus lines business with a weighting in favour of the industrial and commercial sectors, binding authority business comprising mainly non-standard commercial and residential risks and specialist sectors, including terrorism, power (electricity) generation, engineering and nuclear risks.

Business is written through the broker network with a significant proportion using the framework of coverholders (or managing general agencies) and other similar delegated authority arrangements.

2018 performance

Lloyd's gross written premium for 2018 was £9,687m (2017: £8,965m), an increase of 8.1%. The Lloyd's property line reported an accident year ratio of 114.0% (2017: 131.5%).

Despite significant 2017 losses and further losses in 2018, there has remained an abundance of global capacity available. This has continued to constrain the extent of increases to pricing levels needed to reflect the inherent underlying levels of risk being underwritten. Overall pricing has increased, although there are wide variations across the book.

2018 income growth was again primarily driven by US binding authority business and to a lesser extent US and non-US open market business. Non-US binding authority business showed a slight contraction as did engineering, reflecting reduced appetite in the lines by some syndicates due to deteriorating loss experience. Terrorism also continued to see downward pricing pressure.

Prior year movement

The prior year movement was a release of 3.6% (2017: 3.9%). Recent years of account have seen elevated levels of catastrophe losses, particularly losses arising within the US windstorm season. These losses mainly impacted the direct and facultative property insurance lines on the 2016 and 2017 years of account. At the end of 2017 a number of these losses had only just occurred, making it more difficult to determine the level of reserves required. The 2018 calendar year has seen a release of prior year reserves for these 2017 windstorm losses and other prior year major losses.

Looking ahead

2018 saw considerable change within the market place against a backdrop of challenging conditions. This has been driven in part by another year of above average natural catastrophe losses and excess global capacity. Significant remedial action is being taken and the successful execution and delivery of plans will be critical for 2019. Difficult decisions regarding existing accounts, or indeed the appropriateness of new accounts, will continue to have to be made during 2019.

Casualty

The casualty market at Lloyd's comprises a broad range of sectors. The most significant are general liability and professional liability. Although shorter-tail in nature than most casualty lines, accident and health business is also included within this sector. The US market is the largest single market for Lloyd's casualty followed by the UK, Canada and Australia.

2018 performance

Lloyd's gross written premium for 2018 was £9,094m (2017: £8,464m), an increase of 7.4%. This increase was largely driven by further growth in cyber, warranty and indemnity business, and US general liability business. The Lloyd's casualty line reported an accident year ratio of 103.9% (2017: 103.7%).

The wider casualty market in 2018 remained replete with capacity. This suppressed price increases, often keeping them below widely agreed-upon claims inflation assumptions.

The growth in cyber insurance products is a continuing trend, illustrating how the market is responding to rapidly evolving exposures, with many customers being first-time buyers. This growth is expected to continue. There was some organic premium growth in other traditional lines driven by insureds experiencing higher turnover, wage rolls and fee income, reflecting a slowly improving economic environment. In other lines, some market participants have recently cut back or exited, causing some price strengthening and the overall growth in casualty business to slow. Niche and heavy industry areas, in particular, have seen greater focus on underwriting, not just in terms of pricing but also in relation to reviews of programme structure and policy terms.

Prior year movement

The prior year movement was a release of 1.0% (2017: 0.6%).

Casualty lines have been subject to increased market oversight throughout 2018 given their uncertain, long-term nature. As a result of this additional oversight, a number of casualty classes have seen increases in their reserves in 2018. Given the fairly stable experience for this line of business in 2018, this strengthening of reserves has acted to reduce the reserve releases across the market compared to previous years. The continued release of reserves on prior years of account is, however, still in line with our expectations. Reserve releases would generally still be expected for this line given the tendency for some managing agents to hold high initial reserves for a number of years, where claims are expected to emerge over a long period of time. This longer emergence period leads to greater uncertainty for these lines when compared to property lines, which have shorter periods of exposure.

Going forward into 2019, the Corporation will continue to monitor the adequacy of market-wide casualty reserves, ensuring that we engage with managing agents writing material casualty business. This increased level of oversight is warranted given the current tough market conditions and the fact that it will take many years to confirm whether any adjustments to these reserves are sufficient.

Looking ahead

The casualty market's performance is highly correlated with both economic and legal conditions. Despite the global economic climate having improved since the late 2000s there remain certain sectors, particularly within financial and professional lines, that are more exposed to the prevailing fragile economic environment, with the potential to cause volatility in results.

While the legal and regulatory environment varies across territories and jurisdictions, there is a general trend of increasing regulation and litigiousness in many regions of the world and in some territories fuelled by third party litigation funding, which may lead to an increase in the frequency and severity of claims. Additionally, increases in inflation will put more pressure on attritional loss ratios for open claims as well as future years of account.

The global cyber insurance market continues to expand, with high profile breaches and evolving legislation driving increased product demand. A significant proportion of the business written is US-domiciled, however growth in other territories has been witnessed, particularly in Europe where the introduction of the General Data Protection Regulations in May 2018 encouraged new buyers to the market. Lloyd's writes approximately a quarter of the global market share and pioneered many of the original products in this line and remains at the leading edge of product development by providing innovative, bespoke and risk transfer solutions in both standalone products or with coverage embedded or blended with traditional product lines. Risk aggregation and monitoring tools, introduced to understand and manage the exposures to cyber risk across the Lloyd's market, remain under scrutiny and will continue to be enhanced further in 2019.

Generally, the market in all casualty lines remains historically competitive, with many participants having grown in recent years, often through delegated underwriting arrangements. However, there now appears to be some signs of stabilisation and additionally certain casualty lines of business, typically ones which have experienced deterioration in recent back years, have begun to come under some increased pressure on terms, conditions and pricing in an attempt to return them to profitability.

Marine

A diverse mix of marine business is placed at Lloyd's who are regarded as industry leaders in the line. Principal lines of business include cargo, hull, marine liability, specie and fine art.

2018 performance

Lloyd's gross written premium for 2018 was £2,603m (2017: £2,506m), an increase of 3.9%. The Lloyd's marine line reported an accident year ratio of 115.6% (2017: 121.8%).

While a competitive environment persisted across the marine lines, reflective of available capacity, the pricing environment was generally positive reversing the trend of prior years. This was particularly apparent across the three main lines of cargo, hull and yacht in the final quarter of the year.

Political and credit risks, which continue to perform well, experienced some growth. Overall performance, however, remained marginal as a series of large losses affected the cargo and hull classes, most notably the major Lürssen shipyard loss in September.

Prior year movement

The prior year movement was a strengthening of 0.4% (2017: 0.6%).

The marine line has performed broadly in line with expectations across a number of years of account during 2018. There has been some favourable movement in large isolated events, such as the Tianjin port explosion that impacted the 2015 year of account. Despite this favourable experience, there is a tendency on this line for the view of claims to be held for a number of years to allow for any uncertainty. In addition, there have been late notifications of claims and some syndicates have reviewed their methodology to derive the reserves, which in aggregate has led to an overall slight strengthening of prior year reserves in 2018.

Looking ahead

It was hoped that the effects of the hurricane-led losses in 2017 would act as a catalyst for price improvement in 2018 but the early positive movement seen in the final quarter of 2017 lost momentum in the first half of 2018.

Following a difficult 2019 planning season for marine business, which resulted in restriction in capacity for some of the major lines, conditions may now exist for further market stabilisation as syndicates continue to seek a return to profit.

Energy

The Lloyd's energy line includes a variety of onshore and offshore property and liability sectors, ranging from construction to exploration, production, refining and distribution.

2018 performance

Gross written premium for the Lloyd's energy line in 2018 was £1,404m (2017: £1,253m), an increase of 12.1%. The Lloyd's energy line reported an accident year ratio of 105.6% (2017: 107.7%).

The positive pricing environment across all sub-lines contributed to the overall growth in premium. Pricing increases were particularly evident in the offshore and onshore property lines, materially reversing the prior year trend.

The accident year performance in energy was impacted by several substantial current year onshore property losses, balanced somewhat by benign loss activity for offshore property.

Prior year movement

The prior year movement was a release of 18.2% (2017: 21.1%). The energy line of business has seen continued prior year reserve releases over 2018. This line contains a mix of contracts that give rise to claims that are settled on both a short-term and long-term time horizon. Of the short-term contracts, energy offshore property has performed most favourably against expectations. Likewise, the offshore liability line has performed well over 2018, with prior year releases being made across a number of older years of account. Given that the energy line is exposed to isolated large losses, a reduction in the view of claims for these large losses also drives reserve releases.

Looking ahead

In previous years, a downswing in the oil price heralded a negative pricing environment for offshore property and it will be interesting to see whether the current discipline in the line is maintained by the upstream market, should the current oil price trend continue for any length of time.

For onshore property, there is anecdotal evidence to suggest market resolve exists to improve terms and conditions in light of another year of substantial loss activity.

2018 Highlights *continued*

Motor

Lloyd's motor market primarily covers UK private car, commercial and fleet business. Private car represents around 35% of Lloyd's UK motor premium and includes niche motor risks. Lloyd's commercial and fleet business is very diverse, ranging from light commercial vehicles and taxis to buses and heavy haulage.

International motor is also written; a large proportion emanates from North America, including private auto and static risks such as dealers open lot.

2018 performance

Gross written premium in 2018 was £1,037m (2017: £1,057m), a decrease of 1.9%. The Lloyd's motor line reported an accident year ratio of 101.8% (2017: 114.4%).

Underwriting conditions in the UK motor market continue to be challenging. However, the market saw far more robust price strengthening during 2018 following the Ogden discount rate change in February 2017.

International motor continues to perform poorly. While the beginning of the year saw very little in terms of rate strengthening, it appears that there have been some positive signs towards the end of the year and going into 2019 as some market participants reviewed their appetite and capacity in this line.

Prior year movement

The prior year movement was a release of 3.1% of net earned premium (2017: strengthening of 7.9%). This is driven by favourable claims experience for both UK and overseas motor.

Looking ahead

At the end of 2018, the Civil Liability Bill received royal assent. While this Bill specifically deals with the Ogden discount rate, the proposed amendment to the current rate will not be known until the middle of 2019. This Bill also introduces reforms which are aimed at reducing fraudulent whiplash claims. These reforms will not be introduced until 2020 so it unlikely to have any material impact on loss ratios for some time.

Starting in 2019, the Motor Insurers' Bureau has also agreed to mutualise risks for terrorism claims. This will be good news to UK motor insurers. It is unclear what impact these changes will have on premiums, but it should create more certainty for motor reinsurers.

2019 is likely to see further restrictions on capacity for international motor, although other market participants may see this as an opportunity to write new business at higher rates.

Aviation

Lloyd's writes across all main business sectors including airline, aerospace, general aviation, space and war. Airline (hull and liability) is the largest sector but Lloyd's is also actively involved in the underwriting of general aviation (eg privately owned light aircraft, helicopters and large private corporate jets), airport liability, aviation product manufacturers' liability, aviation, war/terrorism and satellite launch and in-orbit risks.

2018 performance

Gross written premium was £549m (2017: £687m), a decrease of 20.1%. The Lloyd's aviation line reported an accident year ratio of 119.8% (2017: 100.6%).

There were a few large losses in 2018 but overall major loss activity remained relatively benign. Following the trend of recent years, results have continued to be impacted by the frequency and cost of attritional claims eroding premium and deductible levels. Airline and general aviation continued to be the main lines contributing to the negative result, alongside space which experienced some large loss estimates. Consolidation and market withdrawals, driven by sustained poor performance, have led to a gradual decline in industry capacity levels. This has stimulated the extent of price increases as the year progressed.

Prior year movement

The prior year movement was a release of 7.8% (2017: strengthening of 1.6%). The aviation line of business has seen prior year reserve releases over 2018. Reserving prudence for this class is generally held for large isolated losses, for which the losses estimates during 2018 have remained stable. Despite seeing above average attritional claims experience, release of reserves held for large losses has offset this adverse experience. The adverse attritional experience is mostly driven by space losses on the 2016 and 2017 years of account.

Looking ahead

The steady growth in industry exposures shows no sign of abating over the next few years. While safety is likely to continue to improve, higher aircraft repair costs and the increasing values of engines and airframes will continue to drive higher levels of attrition, absent a commensurate increase in deductibles.

Notwithstanding the rise in general pricing levels in 2018, industry claims are still likely to materially exceed premiums in a normal loss year. Strict adherence to underwriting discipline regarding risk selection, exposure management controls (eg cyber, war accumulations) and rigorous portfolio management remain essential in order to generate positive returns.

Reinsurance

Property	Gross written premium	£m	Combined ratio	%	Underwriting result	£m
	2014	4,472	2014	77.0	2014	801
	2015	4,627	2015	76.3	2015	794
	2016	5,022	2016	91.8	2016	299
	2017	5,991	2017	130.3	2017	(1,260)
	2018	**6,440**	**2018**	**116.2**	**2018**	**(672)**

Casualty	Gross written premium	£m	Combined ratio	%	Underwriting result	£m
	2014	1,779	2014	87.6	2014	187
	2015	1,797	2015	100.0	2015	0
	2016	2,096	2016	98.1	2016	33
	2017	2,223	2017	102.1	2017	(39)
	2018	**2,541**	**2018**	**96.1**	**2018**	**78**

Specialty	Gross written premium	£m	Combined ratio	%	Underwriting result	£m
	2014	2,237	2014	86.5	2014	225
	2015	2,169	2015	93.3	2015	110
	2016	2,290	2016	87.7	2016	216
	2017	2,346	2017	101.8	2017	(31)
	2018	**2,089**	**2018**	**90.9**	**2018**	**138**

2018 Highlights *continued*

Insurance

Property	Gross written premium	£m	Combined ratio	%	Underwriting result	£m
	2014	6,274	2014	87.7	2014	558
	2015	6,893	2015	90.1	2015	501
	2016	7,988	2016	103.4	2016	(202)
	2017	8,965	2017	127.6	2017	(1,757)
	2018	**9,687**	**2018**	**110.4**	**2018**	**(700)**

Casualty	Gross written premium	£m	Combined ratio	%	Underwriting result	£m
	2014	4,959	2014	98.1	2014	74
	2015	5,764	2015	100.1	2015	(5)
	2016	7,131	2016	102.7	2016	(146)
	2017	8,464	2017	103.1	2017	(189)
	2018	**9,094**	**2018**	**102.9**	**2018**	**(183)**

Marine	Gross written premium	£m	Combined ratio	%	Underwriting result	£m
	2014	2,140	2014	95.2	2014	84
	2015	2,245	2015	94.2	2015	108
	2016	2,470	2016	106.2	2016	(129)
	2017	2,506	2017	122.4	2017	(469)
	2018	**2,603**	**2018**	**116.0**	**2018**	**(343)**

Energy	Gross written premium	£m	Combined ratio	%	Underwriting result	£m
	2014	1,532	2014	83.4	2014	181
	2015	1,414	2015	76.0	2015	247
	2016	1,110	2016	92.6	2016	59
	2017	1,253	2017	86.6	2017	105
	2018	**1,404**	**2018**	**87.4**	**2018**	**113**

Motor	Gross written premium	£m	Combined ratio	%	Underwriting result	£m
	2014	1,213	2014	106.6	2014	(71)
	2015	1,120	2015	102.0	2015	(17)
	2016	1,047	2016	111.5	2016	(103)
	2017	1,057	2017	122.3	2017	(188)
	2018	**1,037**	**2018**	**98.7**	**2018**	**12**

Aviation	Gross written premium	£m	Combined ratio	%	Underwriting result	£m
	2014	581	2014	102.7	2014	(10)
	2015	587	2015	95.7	2015	19
	2016	627	2016	84.7	2016	71
	2017	687	2017	102.2	2017	(11)
	2018	**549**	**2018**	**112.0**	**2018**	**(49)**

Statement of Council's Responsibilities

Statement of Council's Responsibilities

The Pro Forma Financial Statements (PFFS) are prepared so that the financial results of Lloyd's and its members taken together and their net assets can be compared as closely as possible with general insurance companies.

The Council is responsible for the preparation and approval of the PFFS.

The maintenance and integrity of the Lloyd's website is the responsibility of the Council; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website.

Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Report of PricewaterhouseCoopers LLP to the Council on the 2018 Pro Forma Financial Statements

Independent Reasonable Assurance Report of PricewaterhouseCoopers LLP to the Council of Lloyd's on the preparation of the 2018 Lloyd's Pro Forma Financial Statements

Conclusion

In our opinion the Council of Lloyd's has prepared the Lloyd's Pro Forma Financial Statements (the "PFFS") for the financial year ended 31 December 2018, defined below, in all material respects in accordance with the basis of preparation set out in note 2.

This opinion is to be read in the context of what we say in the remainder of this report.

What we have assured

The PFFS, which are prepared by the Council of Lloyd's, comprise: a pro forma profit and loss account, a pro forma statement of other comprehensive income, a pro forma balance sheet, a pro forma statement of cash flows, and notes 1-24.

The financial reporting framework that has been applied in their preparation is the basis of preparation set out in note 2.

Our assurance does not extend to information in respect of earlier periods or to any other information included in the Lloyd's Annual Report within which the PFFS for the year ended 31 December 2018 are included.

What a reasonable assurance engagement involves

We performed a reasonable assurance engagement in accordance with International Standard on Assurance Engagements 3000 (Revised) – 'Assurance Engagements other than Audits and Reviews of Historical Financial Information', issued by the International Auditing and Assurance Standards Board.

We complied with the Institute of Chartered Accountants in England and Wales (ICAEW) Code of Ethics, which includes independence and other requirements founded on fundamental principles of integrity, objectivity, professional competence and due care, confidentiality and professional behaviour. We apply International Standard on Quality Control (UK) 1 and accordingly maintain a comprehensive system of quality control including documented policies and procedures regarding compliance with ethical requirements, professional standards and applicable legal and regulatory requirements.

The PFFS have been compiled in part from an aggregation of financial information extracted from the balance sheet and profit and loss account included in syndicate annual accounts by the managing agent of each syndicate, which has been submitted to the Council of Lloyd's and on which the auditors of each syndicate have reported. Our work did not involve assessing the quality of those audits or performing any audit procedures over the financial information of the syndicates.

Our examination of the preparation of the PFFS consisted principally of:

- obtaining an understanding of how the Council of Lloyd's has compiled the PFFS from the audited syndicate annual returns and accounts, the audited Society of Lloyd's Group Financial Statements and members' funds at Lloyd's;
- checking (on a sample basis) that the financial information included in the PFFS was correctly extracted from the syndicate annual accounts and the Society of Lloyd's Financial Statements;
- evaluating evidence to support the existence and valuation of members' funds at Lloyd's; and
- evaluating the evidence supporting the adjustments made in the preparation of the PFFS and obtaining evidence that the PFFS have been prepared in accordance with the basis of preparation set out in the PFFS notes.

The engagement also involves evaluating the overall presentation of the PFFS. We do not consider the appropriateness of the basis of preparation of the PFFS.

The responsibilities of the Council of Lloyd's and our responsibilities

The Council of Lloyd's is responsible for the preparation and approval of the PFFS in accordance with the basis of preparation set out in note 2. The purpose of the PFFS is to allow the financial results of Lloyd's and its members and their net assets taken together to be compared as closely as possible with the financial reports of general insurance companies.

Our responsibility is to express an opinion about whether the preparation of the PFFS has been performed by the Council of Lloyd's on the basis set out in note 2.

This report including our conclusions has been prepared solely to the Council of Lloyd's in accordance with our engagement letter dated 6 December 2018 (the "instructions"). Our examination has been undertaken so that we might state to the Council of Lloyd's those matters which we are required to state in this report in accordance with the instructions and for no other purpose. To the fullest extent permitted by law, we do not accept or assume any responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

PricewaterhouseCoopers LLP
London
26 March 2019

Pro Forma Profit and Loss Account

(For the year ended 31 December 2018)

Technical account	Note	2018 £m	2018 £m	2017 £m	2017 £m
Gross written premiums	9		35,527		33,591
Outward reinsurance premiums			(9,846)		(8,722)
Premiums written, net of reinsurance			25,681		24,869
Change in the gross provision for unearned premiums		(789)		(847)	
Change in the provision for unearned premiums, reinsurers' share		286		476	
			(503)		(371)
Earned premiums, net of reinsurance			25,178		24,498
Allocated investment return transferred from the non-technical account			367		732
			25,545		25,230
Claims paid					
Gross amount		19,666		18,292	
Reinsurers' share		(5,682)		(3,634)	
			13,984		14,658
Change in provision for claims					
Gross amount		4,895		9,768	
Reinsurers' share		(2,441)		(6,176)	
			2,454		3,592
Claims incurred, net of reinsurance			16,438		18,250
Net operating expenses	11		9,870		9,669
Balance on the technical account for general business			(763)		(2,689)
Non-technical account					
Balance on the technical account for general business			(763)		(2,689)
Investment return on syndicate assets		333		907	
Notional investment return on members' funds at Lloyd's	6	178		722	
Investment return on Society assets		(7)		171	
	12	504		1,800	
Allocated investment return transferred to the technical account		(367)		(732)	
			137		1,068
(Loss)/profit on exchange			(8)		(62)
Other income			34		42
Other expenses			(401)		(360)
Result for the financial year before tax	8		**(1,001)**		**(2,001)**

All operations relate to continuing activities.

Pro Forma Statement of Comprehensive Income

(For the year ended 31 December 2018)

Statement of other comprehensive income	2018 £m	2017 £m
Result for the year	(1,001)	(2,001)
Currency translation differences	(65)	(69)
Other comprehensive losses in the syndicate annual accounts	(3)	(2)
Remeasurement gains/(losses) on pension assets/liabilities in the Society accounts	61	41
Total comprehensive (loss)/income for the year	**(1,008)**	**(2,031)**

Pro Forma Balance Sheet

(As at 31 December 2018)

Investments	Note	£m	2018 £m	£m	2017 £m
Financial investments	13		60,363		55,765
Deposits with ceding undertakings			35		18
Reinsurers' share of technical provisions					
Provision for unearned premiums	18	3,853		3,372	
Claims outstanding	18	19,541		16,811	
			23,394		20,183
Debtors					
Debtors arising out of direct insurance operations	14	9,673		8,882	
Debtors arising out of reinsurance operations	15	7,478		5,921	
Other debtors		1,016		734	
			18,167		15,537
Other assets					
Tangible assets		27		31	
Cash at bank and in hand	16, 22	10,877		12,137	
Other		125		72	
			11,029		12,240
Prepayments and accrued income					
Accrued interest and rent		123		104	
Deferred acquisition costs	18	4,680		4,304	
Other prepayments and accrued income		217		245	
			5,020		4,653
Total assets			**118,008**		**108,396**
Capital, reserves and subordinated debt					
Members' funds at Lloyd's	6	26,483		24,579	
Members' balances	17	(1,472)		–	
Members' assets (held severally)		25,011		24,579	
Central reserves (mutual assets)		2,417		2,188	
	8		27,428		26,767
Subordinated debt	2		794		793
Total capital, reserves and subordinated debt			**28,222**		**27,560**
Technical provisions					
Provision for unearned premiums	18	17,868		16,377	
Claims outstanding	18	60,450		54,893	
			78,318		71,270
Deposits received from reinsurers			169		111
Creditors					
Creditors arising out of direct insurance operations	20	1,325		955	
Creditors arising out of reinsurance operations	21	6,552		5,929	
Other creditors including taxation		2,484		1,781	
			10,361		8,665
Accruals and deferred income			938		790
Total liabilities			**118,008**		**108,396**

Approved by the Council on 26 March 2019 and signed on its behalf by

Bruce Carnegie-Brown
Chairman

John Neal
Chief Executive Officer

Pro Forma Statement of Cash Flows

(For the year ended 31 December 2018)

	Note	2018 £m	2017 £m
Result for the financial year before tax		(1,001)	(2,001)
Increase/(decrease) in gross technical provisions		6,113	7,714
(Increase)/decrease in reinsurers' share of gross technical provisions		(2,918)	(5,930)
(Increase)/decrease in debtors		(2,120)	(1,942)
Increase/(decrease) in creditors		943	1,596
Movement in other assets/liabilities		(424)	66
Investment return		(504)	(1,800)
Depreciation		9	8
Tax paid		(34)	(51)
Foreign exchange		(809)	1,057
Other		(113)	(6)
Net cash flows from operating activities		**(858)**	**(1,289)**
Investing activities			
Purchase of equity and debt instruments		(40,927)	(38,462)
Proceeds from sale of equity and debt instruments		41,316	39,631
Purchase of derivatives		(3,078)	(69)
Proceeds from sale of derivatives		3,070	28
Investment income received		653	801
Other		(538)	171
Net cash flows from investing activities		**496**	**2,100**
Financing activities			
Net profits paid to members		(851)	(1,689)
Net capital transferred into/(out of) syndicate premium trust funds		825	774
Proceeds from sale of debt securities		–	298
Redemption of subordinated notes		–	(392)
Interest paid on subordinated notes		(38)	(53)
Net movement in members' funds at Lloyd's		(1,451)	(123)
Other		104	21
Net cash flows from financing activities		**(1,411)**	**(1,164)**
Net (decrease)/increase in cash and cash equivalents		**(1,773)**	**(353)**
Cash and cash equivalents at 1 January		14,113	14,631
Exchange differences on cash and cash equivalents		55	(165)
Cash and cash equivalents at 31 December	22	**12,395**	**14,113**

Notes to the Pro Forma Financial Statements

(For the year ended 31 December 2018)

1. The Pro Forma Financial Statements

The Pro Forma Financial Statements (PFFS) are prepared so that the financial results of Lloyd's and its members taken together and their net assets can be compared as closely as possible with general insurance companies.

2. Basis of preparation

General

The PFFS have been prepared by aggregating audited financial information reported in syndicate returns and annual accounts (Aggregate Accounts), members' funds at Lloyd's (FAL) and the financial statements of the Society of Lloyd's (the Society) on pages 122-180. Having assessed the principal risks, the Council considered it appropriate to adopt the going concern basis of accounting in preparing the PFFS; the going concern and viability statement of the Society is included within the Society Report on pages 114-115.

The Aggregate Accounts report the audited results for calendar year 2018 and the financial position at 31 December 2018 for all life and non-life syndicates that transacted business during the year. The results and net assets for life syndicates are not material and have not been separately disclosed in the profit and loss account and balance sheet. The results for life business are reported in the segmental analysis (note 9). The Aggregate Accounts are reported as a separate document and can be viewed at lloyds.com/annualreport2018. In order to provide more meaningful information in the Aggregate Accounts and PFFS, the Society has required syndicates to report certain disclosures presented on a consistent basis, which may vary from presentation included in the individual syndicates' annual accounts.

The profit and loss account in the PFFS aggregates the syndicate results, the notional investment return on members' capital and the results of the Society. The balance sheet in the PFFS aggregates the assets and liabilities held at syndicate level, members' assets held as FAL and the central resources of the Society.

The PFFS have, where practicable, been prepared in accordance with United Kingdom Accounting Standards (UK Generally Accepted Accounting Practice (UK GAAP)), including Financial Reporting Standard 102 (FRS 102) and the applicable Accounting Standard on insurance contracts Financial Reporting Standard 103 (FRS 103). In preparing the PFFS, note disclosures have been included for those areas the Council consider material to enable the PFFS to depict a comprehensive view of the financial results and position of the Lloyd's market and to enable comparison with general insurance companies, with the exception of the following items:

- Use of the aggregation basis to prepare the PFFS;
- Notional investment return on members' funds at Lloyd's;
- The statement of changes in equity;
- Taxation; and
- Related party transactions.

(a) Aggregation

The PFFS have not been prepared in accordance with full consolidation principles and do not present a consolidated view of the results of the Lloyd's business taken as a single entity for the reasons detailed further below. However, the PFFS may be used as a reasonable presentation of the results and state of affairs of the Lloyd's market on a basis that is broadly comparable with general insurance companies.

The syndicates' financial information included in the PFFS has been prepared in accordance with the recognition and measurement requirements of UK GAAP by reference to the accounting policies that are deemed most appropriate by the managing agents. Where different accounting policies have been selected by managing agents in preparing syndicate annual accounts, no adjustments are made to align the bases of recognition and measurement in the PFFS. In addition, no adjustments are made to eliminate inter-syndicate transactions and balances except for those relating to inter-syndicate loans and Special Purpose Arrangements (SPA). Transactions between syndicates and the Society are eliminated in the PFFS. These adjustments are described below:

Inter-syndicate loans

The syndicate annual accounts report debtor and creditor balances for inter-syndicate loans totalling £125m (2017: £122m). These amounts have been eliminated from the amounts reported in the balance sheet to provide a more meaningful presentation of the balance sheet for users of the PFFS (note 8).

Special Purpose Arrangements (SPA)

The Aggregate Accounts include the results and assets of the SPA (see Glossary on page 185). Due to the nature of the SPA, the quota share of the host syndicate's business is reported as gross written premiums in both the host syndicate and the SPA annual accounts. This leads to an overstatement of the original premiums written by the whole Lloyd's market. To provide users of the PFFS with a more meaningful presentation of the market's figures, all the transactions arising from the insurance contracts between the SPA and host syndicates have been eliminated. The key impact of this elimination is that gross written premium is reduced by £643m (2017: £589m). The elimination does not affect the PFFS result or the balance due to members. All other inter-syndicate reinsurance arrangements are included in full.

Transactions between syndicates and the Society

- Central Fund contributions, members' subscriptions and other market charges levied by the Society are reported as net operating expenses in the syndicate annual accounts and as income in the Society financial statements.

— Central Fund claims and provisions to discharge the liability of members where they have unpaid cash calls, and do not have the resources to meet those cash calls, are reported as a profit and loss charge and balance sheet liability in the Society financial statements. The Central Fund's other income includes recoveries from insolvent members. The syndicate annual accounts for calendar year 2018 and earlier years include those members' results and at the balance sheet date will report the outstanding liability within members' balances.
— Loans funding statutory overseas deposits are reported as assets within the syndicate annual accounts and as liabilities in the Society financial statements.

(b) Notional investment return on members' funds at Lloyd's (FAL)

A notional investment return on FAL has been estimated, which is the equivalent of insurance companies generating investment return on the capital that they hold to support their underwriting. Where Lloyd's is the investment manager for FAL, the actual return achieved has been included. For other assets the notional investment return, net of management fees, is estimated on the average value of FAL during the year, based on yields from indices for each type of asset held. The typical investment return on bank deposits has been applied to FAL, provided as letters of credit or bank guarantees. The actual return achieved on FAL investments will differ from the notional return due to individual stocks held, daily cash flows and transactional charges. Notional investment return on FAL is reported in the non-technical account.

Due to the estimation of the notional investment return, movements in FAL recorded within the financing section of the statement of cash flows is comprised of both cash and non-cash activity.

(c) Statement of changes in equity

Where Lloyd's is not the investment manager for FAL, actual changes are not available and therefore a statement of changes in equity has not been included. However, a statement of changes in members' balances has been included in note 17, which, along with the Society's group statement of changes in equity (on page 125), represents the changes in equity of the other components of the PFFS.

(d) Taxation

The PFFS report the market's result before tax. Members are responsible for tax payable on their syndicate results and investment income on FAL. For consistency, the results of the Society are also included pre-tax in the profit and loss account. The balance sheet in the Society financial statements includes the Society's own tax provision balances.

(e) Related party transactions

Individual syndicates or their members do not disclose details of insurance and/or reinsurance transactions with other (non-related) syndicates or members within the market. Therefore analysis and/or disclosure of these transactions within the Lloyd's market in the PFFS is not possible. Other than the disclosures made in note 24, a more detailed related party transaction note is therefore not included within the PFFS. The annual accounts of each syndicate or member provide, where appropriate, the required disclosures on related parties. The related party transactions of the Society are disclosed in note 27 on page 180 of the Society financial statements.

Members' funds at Lloyd's (FAL)

FAL comprise the capital provided by members, which is generally held centrally, to support their underwriting, and are the equivalent of capital shown in insurance companies' accounts. The valuation of FAL has, therefore, been included in the pro forma balance sheet. FAL is available to meet cash calls made on the member in respect of a syndicate liability. The assets in FAL must be readily realisable and may include letters of credit and bank and other guarantees.

The total resources, including FAL, for members writing ongoing insurance must be at least equivalent to the aggregate of the member's Economic Capital Assessment (ECA) requirement and certain liabilities in respect of its underwriting business. Each member's ECA to support its underwriting at Lloyd's is determined using Lloyd's Solvency Capital Requirement to ultimate capital setting methodology.

Subordinated debt

In accordance with the terms of the Society's subordinated debt, the capital raised is available for payment to policyholders in advance of repayment to the note holders and is included in "capital, reserves and subordinated debt" in the pro forma balance sheet. Note 22 to the Society financial statements on page 176 provides additional information.

Society financial statements

The PFFS include the results and net assets reported in the consolidated financial statements of the Society prepared in accordance with UK GAAP, comprising the financial statements of the Society and all its subsidiary undertakings, the Lloyd's Central Fund and the Society's interest in associates.

3. Accounting policies notes

Sources of significant accounting judgements and estimation uncertainty

The PFFS aggregates judgements, estimates and assumptions made by managing agents in respect of syndicate balances, and the Council, in respect of the Society and FAL balances. These judgements, estimates and assumptions affect the application of accounting policies and reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected. In particular, information about significant areas of estimation uncertainty and critical judgements in applying accounting policies that have the most significant effect on the amounts recognised in the PFFS are described in the following accounting policies:

- Claims provisions and related recoveries (including provision for outstanding claims) (see note 3(a) and note 18);
- Premiums written (estimates for premiums written under delegated authority agreements) (see note 3(a) and note 9);
- Investments (valuations based on models and unobservable inputs) (see note 3(a) and note 13); and
- Notional investment return on FAL (estimate based on yields from indices for each type of asset held) (see note 2(b), note 3(b) and note 6).

The most critical accounting estimate included within the balance sheet is the estimate for outstanding claims. The total estimate, net of reinsurers' share, as at 31 December 2018 is £40,909m (2017: £38,082m) and is included within the pro forma balance sheet.

(a) Aggregate accounts

General

Under the Insurance Accounts Directive (Lloyd's Syndicate and Aggregate Accounts) Regulations 2008, as amended by The Statutory Auditors and Third Country Auditors Regulations 2017, managing agents must prepare syndicate annual accounts under UK GAAP. However, where UK GAAP permits different accounting treatments, each managing agent is able to adopt the accounting policies it considers most appropriate to its syndicate. The following accounting policies are, therefore, an overview of the policies generally adopted by syndicates.

Premiums written

Premiums written represent premiums on business incepting during the year, together with adjustments for premiums written in previous accounting periods. Premiums written are stated before deduction of commissions but net of taxes, duties levied on premiums and other deductions.

Unearned premiums

Written premiums are recognised as earned according to the risk profile of the policy. Unearned premiums represent the proportion of premiums written in the year that relate to unexpired terms of policies in force at the balance sheet date, calculated on the basis of established earnings patterns or time apportioned as appropriate.

Outward reinsurance premiums

Outward reinsurance premiums comprise the cost of reinsurance arrangements placed and are accounted for in the same accounting period as the related insurance contracts. The provision for reinsurers' share of unearned premiums represents that part of reinsurance premium ceded that is estimated to be earned in following financial years.

Claims provisions and related recoveries

Gross claims incurred comprise the estimated cost of all claims occurring during the year, whether reported or not, including related direct and indirect claims handling costs and adjustments to claims outstanding from previous years.

The provision for claims outstanding is assessed on an individual case basis and is based on the estimated ultimate cost of all claims notified but not settled by the balance sheet date, together with the provision for related claims handling costs. The provision also includes the estimated cost of claims incurred but not reported (IBNR) at the balance sheet date based on statistical methods.

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. The amount of salvage and subrogation recoveries is separately identified and, where material, reported as an asset.

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 line of business, the claims experience for the year and the current security rating of the reinsurers involved. Statistical techniques 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 future 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 of each syndicate's managing agent 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, which may result in significant adjustments to the amounts provided. Adjustments to the amounts of claims provisions established in prior years are reflected in the financial statements for the period in which the adjustments are made. The methods used, and the estimates made, are reviewed regularly.

Additional information on insurance risk is disclosed in note 4.

Discounted claims provisions
Due to the long delay between the date of an incurred claim and the final settlement of the claim, the outstanding claims provisions are discounted to take account of the expected investment income receivable between claim event and settlement dates on the assets held to cover the provisions. This is only applicable to the syndicates that discount their claims provisions.

Unexpired risks provision
A provision for unexpired risks is made where claims and related expenses arising after the end of the financial period in respect of contracts concluded before that date are expected to exceed the unearned premiums under these contracts, after the deduction of any acquisition costs deferred.

The provision for unexpired risks is calculated at syndicate level by reference to lines of business that are managed together, and may take into account relevant investment return.

Acquisition costs
Acquisition costs, comprising commission and other costs related to the acquisition of new insurance contracts are deferred to the extent that they are attributable to premiums unearned at the balance sheet date.

Foreign currencies
The Council considers that the functional currency and the presentational currency of the PFFS and Aggregate Accounts is sterling. In the context of the PFFS and Aggregate Accounts the Council views this to be the equivalent of a group which has different operating units with a mix of functional currencies.

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions, or the average rate may be used when this is a reasonable approximation.

At each period end foreign currency monetary items are translated using the closing rate. For this purpose, all assets and liabilities arising from insurance contracts (including unearned premiums, deferred acquisition costs and unexpired risks provisions) are monetary items.

Foreign exchange gains and losses resulting from the settlement of transactions and from the translation at period end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the non-technical account.

Foreign exchange gains and losses resulting from the settlement of transactions and from the translation at period end exchange rates of non-monetary assets and liabilities denominated in foreign currencies are recognised in other comprehensive income for those items where the gain or loss is required to be recognised within other comprehensive income, and in the non-technical account where the gain or loss is required to be recognised within profit or loss.

Investments
Investments are stated at fair value at the balance sheet date. For this purpose, listed investments are stated at their bid price market value, and deposits with credit institutions and international deposits are stated at cost, less any provision for impairment.

Unlisted investments for which a market exists are stated at the average price at which they are traded on the balance sheet date or the last trading day before that date.

Syndicate investment return
Syndicate investment return comprises all investment income, realised investment gains and losses and movements in unrealised gains and losses, net of investment expenses, charges and interest.

Realised gains and losses on investments carried at market value are calculated as the difference between sale proceeds and purchase price.

Unrealised gains and losses on investments represent the difference between the valuation at the balance sheet date and the valuation at the previous balance sheet date, or purchase price, if acquired during the year, together with the reversal of unrealised gains and losses recognised in earlier accounting periods in respect of investment disposals in the current period.

Syndicate investment return is initially recorded in the non-technical account. A transfer is made from the non-technical account to the general business technical account where the investments generating the return relate to insurance business.

Taxation
The PFFS report the market's result before tax because it is the members rather than the syndicates that are responsible for tax payable on their syndicate results and investment income on FAL. No provision has therefore been made in the PFFS for income tax payable by members. Any payments on account of members' tax liabilities made on their behalf by a syndicate during the year are included in the balance sheet within other debtors or other creditors including taxation.

Operating expenses
Operating expenses have been charged to the syndicates in accordance with the policies adopted by the managing agents.

3. Accounting policies notes *continued*

Profit commission

Where profit commission is charged by the managing agent it will normally be fully paid once the appropriate year of account closes, normally at 36 months. The profit commission is accrued in the profit and loss account in accordance with the earned profit.

Managing agents may make payments on account of their anticipated profit commission from the syndicate premiums trust funds prior to the closure of a year of account where they have transferred open year surpluses (interim profits) from the syndicate level premiums trust funds to the members' personal reserve fund. Any payments on account of such commission are restricted to the profit commission expensed in the profit and loss account in striking the level of interim profits declared and subsequently released.

Cash at bank and in hand

Cash at bank and in hand includes cash in hand, deposits held at call with banks, other short term highly liquid investments with original maturities of three months or less and bank overdrafts. Bank overdrafts, when applicable, are shown within borrowings in current liabilities.

Comparative disclosures

Certain comparative balances have been reclassified to be consistent with current year presentation.

(b) Member's funds at Lloyd's (FAL)

FAL is valued in accordance with their market value at the year end, and using year end exchange rates. Investments are stated at fair value at the balance sheet date. For this purpose, listed investments are stated at their bid price market value, and deposits with credit institutions and international deposits are stated at cost. Unlisted investments for which a market exists are stated at the average price at which they are traded on the balance sheet date or the last trading day before that date. Letters of credit are stated at the amount guaranteed by the issuing credit institution.

As disclosed in the basis of preparation a notional investment return on FAL is estimated, which is recognised in the non-technical account.

Members that only participate on one syndicate may hold the capital supporting their underwriting in their syndicate's premium trust funds. Where a member takes advantage of this facility, the capital held in the premium trust fund is reported within members' balances and the investment return retained within the non-technical account.

(c) Society of Lloyd's (the Society)

The accounting policies adopted in the Society financial statements are set out on pages 127 to 137. No adjustments have been made to the information incorporated into the PFFS as the Council do not consider there to be any material accounting policy differences between the existing IFRS accounting policies and the recognition and measurement requirements of UK GAAP.

4. Risk management

Governance framework

The following governance structure relates to the Society as a whole, as the preparer of the PFFS. Individual syndicates will report, in their syndicate annual accounts, the governance structure applied to them by their managing agents.

An Act of Parliament, the Lloyd's Act 1982, defines the governance structure and rules under which Lloyd's operates. Under the Act, the Council is responsible for the management and supervision of the market. Lloyd's is regulated by the Prudential Regulation Authority (PRA) and Financial Conduct Authority (FCA) under the Financial Services and Markets Act 2000.

The Council normally has six working, six external and six nominated members. The working and external members are elected by Lloyd's members. The Chairman and Deputy Chairmen are elected annually by the Council from among its members. All members are approved by the PRA.

The Council can discharge some of its functions directly by making decisions and issuing resolutions, requirements, rules and byelaws. Other decisions are delegated to the Board and associated committees.

The Board is responsible for the day to day management of the Lloyd's market. It lays down guidelines for all syndicates and operates a business planning and monitoring process to safeguard high standards of underwriting and risk management, thereby improving sustainable profitability and enhancing the financial strength of the market.

The principal committees of the Council are the Nominations and Governance Committee and the Remuneration Committee.

The principal committees of the Board are the Audit Committee, the Risk Committee, the Market Supervision and Review Committee, the Capacity Transfer Panel and the Investment Committee.

Capital management objectives, policies and approach

Capital framework at Lloyd's

The Society is a regulated undertaking and subject to the supervision of the Prudential Regulation Authority (PRA) under the Financial Services and Markets Act 2000. Within this supervisory framework, the Corporation applies capital requirements at member level and centrally to ensure that Lloyd's complies with Solvency II, and beyond that to meet its own financial strength, licence and ratings objectives.

Although, as described below, Lloyd's capital setting processes use a capital requirement set at syndicate level as a starting point, the requirement to meet Solvency II and Lloyd's capital requirements apply at an overall and member level only, not at a syndicate level. Accordingly, the capital requirements in respect of individual syndicates are not disclosed in these financial statements.

Lloyd's capital setting process
In order to meet Lloyd's requirements, each syndicate is required to calculate its Solvency Capital Requirement (SCR) for the prospective underwriting year. This amount must be sufficient to cover a 1 in 200 year loss, reflecting uncertainty in the ultimate run-off of underwriting liabilities (SCR "to ultimate"). The SCRs of each syndicate are subject to review by the Corporation and approval by the Lloyd's Capital and Planning Group.

A syndicate may be comprised of one or more underwriting member of Lloyd's. Each member is liable for its own share of underwriting liabilities on the syndicate(s) on which it is participating but not other members' shares. Accordingly, the capital requirement that Lloyd's sets for each member operates on a several basis. Each member's SCR shall thus be determined by the sum of the member's share of the syndicate SCR "to ultimate". Where a member participates on more than one syndicate, a credit for diversification is provided to reflect the spread of risk, but consistent with determining an SCR that reflects the capital requirement to cover a 1 in 200 year loss "to ultimate" for that member. Over and above this, the Corporation applies a capital uplift to the member's capital requirement to determine the Economic Capital Assessment (ECA). The purpose of this uplift, which is a Lloyd's not a Solvency II requirement, is to meet Lloyd's financial strength, licence and ratings objectives. The capital uplift applied for 2018 was 35% of the member's SCR "to ultimate".

Solvency Capital Requirement (Solvency II basis)

The SCR represents the amount of capital required to withstand a 1 in 200 year loss event over a one year horizon. Given Lloyd's unique structure there are two SCRs that are monitored under the Solvency II regime:

The Lloyd's market wide SCR (MWSCR) is calculated to cover all of the risks of "the association of underwriters known as Lloyd's", ie those arising on syndicate activity, members' capital provided at Lloyd's and the Society taken together, at a 99.5% confidence level over a one year time horizon as provided for in Solvency II legislation. All of the capital of the component parts of the market taken together are available to meet the MWSCR.

The Lloyd's central SCR (CSCR) is calculated in respect of only the risks facing the Society, including the Central Fund at the same confidence level and time horizon used to calculate the MWSCR.

The material risk is that members do not have sufficient funds to meet their underwriting losses even having complied with the Corporation's rigorous capital setting rules.

Individual syndicates are also required to calculate a SCR, at a 99.5% confidence level over a one year horizon, for each underwriting year; this drives the determination of member level SCRs. Each member's SCR is derived as the sum of the member's share of the syndicate's one year SCR. Where a member participates on more than one syndicate, a credit for diversification is provided to reflect the spread of risk.

The MWSCR and CSCR are derived from the Lloyd's Internal Model (LIM), which has been approved by the PRA. Individual syndicates also derive SCRs from their own internal models that are subject to approval by the Corporation's Capital and Planning Group. The appropriateness of each syndicate's internal model, including changes thereto and the reasonableness of the key assumptions are assessed as part of the Corporation's oversight of the Lloyd's market.

The Lloyd's Internal Model

The LIM is a purpose-built model designed to calculate the MWSCR and CSCR as required under Solvency II. It covers all risk types and all material risks for the aggregation of syndicates as well as for the Society, allowing for the unique capital structure of Lloyd's. The LIM consists of three main components: the Lloyd's Investment Risk Model (LIRM), which simulates economic variables and total assets returns; the Lloyd's Catastrophe Model (LCM), which models catastrophe risk using syndicates' views of risk; and the Capital Calculation Kernel (CCK), which is the main element of the LIM where all other risks are simulated and all risks are combined.

Syndicates calculate their own SCR. However, the market wide and central capital requirements are derived from the Corporation's parameterisation at a whole market level to build a view of total market capital requirements from the ground up using market level assumptions. The LIM uses a methodology whereby losses from insurance and other risks are simulated by line of business, allocated to syndicates and through to members to assess the level of capital required by the market and centrally to meet 1 in 200 year losses over the one year time horizon.

Syndicates are the source of the majority of risks. They source all of the insurance business; manage the bulk of the asset portfolios; hold the majority of the counterparty exposures; and conduct most of the day to day operational activity. The syndicate risks include: insurance risk (underwriting, reserving and catastrophe risk); market risk on central assets; market risk on syndicate assets (including credit risk on Premiums Trust Funds (PTF)); reinsurance and other credit risk; and syndicate operational risk. At the central level, additional risks arise from central operational risk and pension fund risk.

4. Risk management *continued*

Details of the major risk components are set out below.

Insurance risk

The dominant category of risk faced by Lloyd's syndicates is insurance risk. This is the risk arising from the inherent uncertainties as to the occurrence, amount and timing of insurance liabilities. In practice, insurance risk can be subdivided into:

(i) underwriting risk;
(ii) reserving risk;
(iii credit risk; and
(iv) catastrophe risk.

Underwriting risk

This includes the risk that a policy will be written for too low a premium, provide inappropriate cover, or that the frequency or severity of insured events will be higher than expected.

Underwriting strategy is agreed by the Board of each managing agent and set out in the syndicate business plan that is submitted to the Corporation for approval each year. Approval of business plans – and setting the capital requirements needed to support these plans – is the key control the Corporation uses to manage underwriting risk.

The Corporation reviews each syndicate business plan to ensure it meets Lloyd's standards and is consistent with the capabilities of the managing agent. Once a plan is agreed, the Corporation uses performance management data to identify whether each syndicate's business performance is progressing in line with the business plan or that variations are understood and accepted.

The managing agents' underwriting controls should ensure that underwriting is aligned with their strategy, agreed business plan and underwriting policy.

Managing agents are expected to have controls in place to ensure that regulatory requirements and the scope of Lloyd's market licences are clearly understood and that risks are written within those requirements.

Managing agents need to have clear processes for pricing business and an audit trail to show how pricing will deliver the projected results within the approved business plan and how pricing will be managed over the relevant underwriting cycle.

Reserving risk

Reserving risk arises where the reserves established in the balance sheet are not adequate to meet eventual claims arising. The level of uncertainty varies significantly across lines of business but can arise from inadequate reserves for known or Incurred But Not Reported (IBNR) claims. These shortfalls can arise from inadequate reserving processes or from the naturally uncertain progress of insurance events.

Lloyd's current level of aggregate market reserves remains robust and the continued level of overall reserve releases are supported by underlying claims experience being more favourable than expected. This will not necessarily translate to all syndicates. There are currently few specific reserving issues and the main perceived risks relate to macro influences such as inflation or changes in legislation, or prescribed levels of payout. The Corporation analyses reserve developments at line of business and syndicate levels quarterly; and briefs the market on issues it considers need to be taken into account.

Case-specific claim reserves should make financial provision at reported loss levels, without prejudice to coverage.

Legal advisers', underwriters' and loss adjusters' judgement are used to set the estimated case reserves.

Reserving processes use a variety of statistical analyses such as projections of historical loss development patterns, with results adjusted for expert judgement. Lloyd's syndicates have significant exposure to volatile lines of business that carry material inherent risk that the ultimate claims settlement will vary from previous assessments of reserves.

Syndicates' reserves are annually subject to a formal independent actuarial opinion and are monitored by the Corporation. The actuarial opinions are covered by a combination of formal Actuarial Professional Standards and specific Lloyd's guidance and rules.

Credit risk

The market's principal credit risk is that the reinsurance purchased to protect the syndicate's gross losses does not respond as expected. This can occur because the reinsurer is unable to settle its liabilities. Managing agents are expected to have a clear and comprehensive plan for the reinsurance of each syndicate. This takes into account risk appetite for retained insurance risk and the potential for the accumulation of risk.

The managing agent should monitor and assess the security of, and exposure to, each reinsurer and intermediary. Reinsurance credit risk is subject to quarterly review by Lloyd's.

Catastrophe risk

Catastrophe risk is the risk of loss occurring across all lines of business from worldwide natural catastrophe events. Managing agents may use catastrophe modelling software, where appropriate, to monitor aggregate exposure to catastrophe losses. The Corporation has developed a suite of Realistic Disaster Scenarios to measure syndicate level and aggregate market exposure to both natural catastrophes and man-made losses. These are monitored frequently and syndicates supply projected probabilistic exceedance forecasts for Lloyd's key exposures with their capital and business plans. Further enhancements to the monitoring and oversight of aggregate market catastrophe risk exposure have been implemented within the approved internal model under Solvency II.

Lloyd's MWSCR

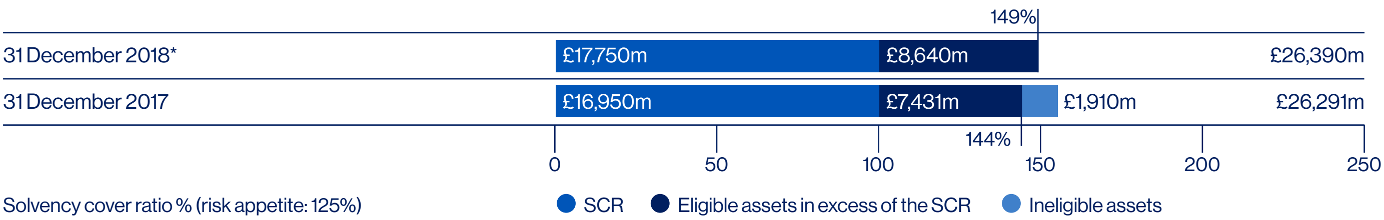
The MWSCR is broken down into the various risk components as shown below.

	31 December 2018* SCR £m	31 December 2017 SCR £m
Reserving risk	6,705	6,183
All other (attritional) underwriting risk	5,865	5,733
Catastrophe risk	2,972	3,923
Market risk	501	181
Reinsurance credit risk	597	523
Operational risk	739	728
Pension risk	22	14
MWSCR before adjustments	**17,401**	**17,285**
Foreign exchange adjustment for movement in H2 2018 (H2 2017)	349	(335)
MWSCR	**17,750**	**16,950**

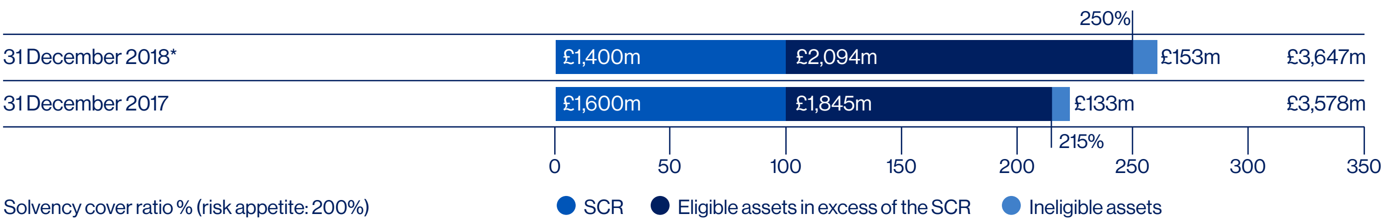
Solvency Capital Requirement coverage

Coverage of the MWSCR and CSCR is an ongoing and continuous requirement and the Corporation reports the results of its solvency test – ie the amount of the MWSCR, eligible assets to cover it and the solvency ratio – on a quarterly basis to the PRA. Lloyd's solvency coverage for both MWSCR and CSCR are set out below.

Lloyd's MWSCR



Lloyd's CSCR



* Represents the position based on the unaudited solvency returns, which may differ from the final audited 2018 submissions.

In addition to the quarterly reporting to the PRA, internal risk appetites have been set to monitor the coverage of the MWSCR and CSCR as part of the risk management framework in place at Lloyd's. During 2018, the solvency coverage ratios for both the MWSCR and the CSCR were in excess of internal risk appetites and regulatory requirements.

- MWSCR: The Society aims to hold market capital sufficient to provide financial security to policyholders and capital efficiency to investors (or "members"). Members are required to put up funds to meet their ECA, which is set as their SCR (on an ultimate view of risk) plus an uplift of 35%. The Corporation does not require excess capital to be held above this level and considers that the risk appetite of 125% of SCR gives an appropriate buffer following diversification benefits. In the event that the capital put up by a member falls below their ECA through losses incurred or an increase in their risk profile, additional funds must be deposited. If members do not recapitalise, their authority to continue to trade is restricted to the level of their available capital or ultimately fully withdrawn and they cease trading. Such action would then reduce their risk and the aggregate MWSCR.
- CSCR: All policies written at Lloyd's are supported by central assets managed by the Society, which underpin the financial strength ratings of the Lloyd's market and its international licence network. Accordingly, the risk appetite for 200% CSCR coverage reflects the prudent approach to maintaining adequate central assets to meet a 1 in 200 year event and be in position to continue to write new business.

Notes to the Pro Forma Financial Statements *continued*

(For the year ended 31 December 2018)

4. Risk management *continued*

Solvency cover ratios	MWSCR coverage	CSCR coverage
31 December 2018*	149%	250%
31 December 2017	144%	215%
Risk appetite for solvency cover ratio	125%	200%

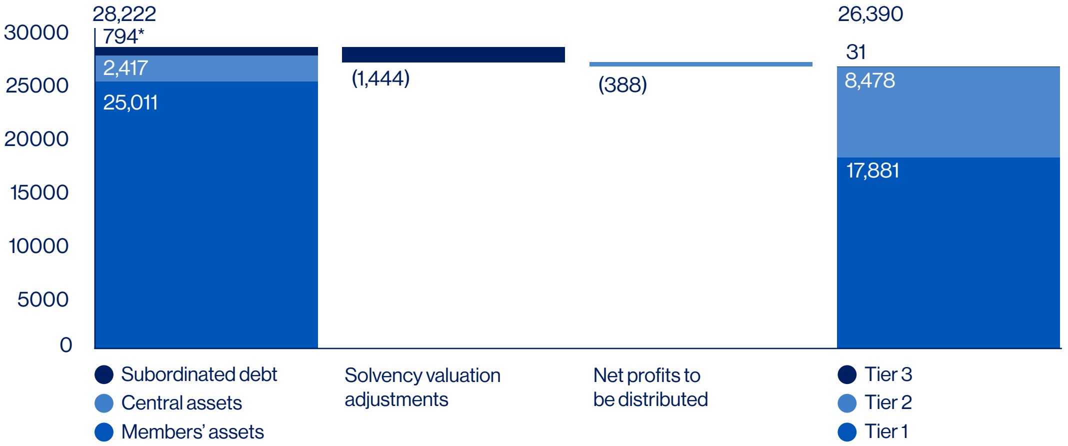
* Based on the unaudited solvency returns.

Assets eligible for solvency

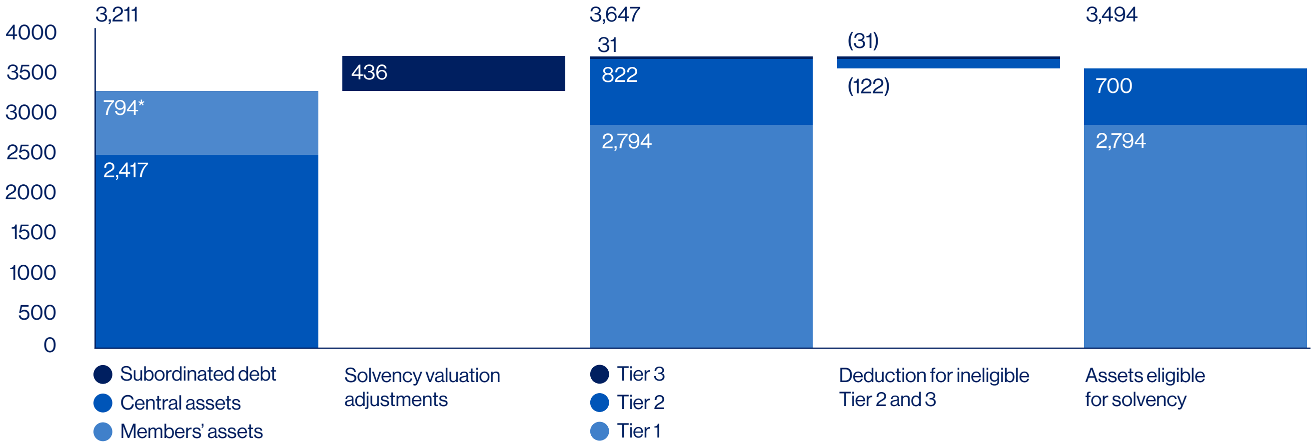
The assets of the syndicates, members' FAL and the Society all contribute towards coverage of the MWSCR, after adjustments to value items in accordance with Solvency II valuation principles. The Society assets and callable layer, in the chain of security, are available to cover the CSCR.

The eligibility of assets to cover the SCR under Solvency II is determined by a tiering test. Tier 1 assets are fully available to cover the SCR while Tier 2 and Tier 3 assets in aggregate can cover up to 50% of the SCR. The majority of the assets available to cover the MWSCR are Tier 1. However, a proportion of members' FAL is provided in the form of letters of credit which are classed as Tier 2 assets, restricting their ability to cover the MWSCR and resulting in a lower solvency cover ratio. These letters of credit are callable on demand and when called, the proceeds, namely cash, would qualify as Tier 1 assets. Under these circumstances, the amounts previously restricted would become fully eligible.

Lloyd's MWSCR (£m)



Lloyd's CSCR (£m)



* Per 31 December 2018 balance sheet. Other amounts represent the position based on the unaudited solvency returns, which may differ from the final audited 2018 submissions.

Claims development table

The tables below illustrate the development of the estimates of earned ultimate cumulative claims for syndicates in aggregate after the end of the underwriting year, illustrating how amounts estimated have changed from the first estimates made. Non-sterling balances have been converted using 2018 year end exchange rates to aid comparability. As these tables are on an underwriting year basis there is an apparent jump from figures for the end of the underwriting year to one year later as a large proportion of premiums are earned in the year of account's second year of development.

Advantage has been taken of the transitional rules of FRS 103 that permit the stepped increase in disclosure of claims development information. The claims development information disclosed will be increased from eight years to ten years over the period 2019-2020.

Gross

Underwriting year	2010 and prior years £m	2011 £m	2012 £m	2013 £m	2014 £m	2015 £m	2016 £m	2017 £m	**2018 £m**	Total £m
At end of underwriting year		9,622	8,887	7,523	7,723	7,464	9,358	17,299	**14,092**	
One year later		16,032	14,327	14,251	14,718	15,427	20,345	27,973		
Two years later		16,144	14,666	14,458	15,621	16,370	21,958			
Three years later		16,222	14,440	14,110	15,512	17,166				
Four years later		16,190	14,406	13,903	16,451					
Five years later		16,020	14,248	14,241						
Six years later		15,899	14,670							
Seven years later		16,438								
Cumulative payments		(14,958)	(12,575)	(11,598)	(11,995)	(11,161)	(12,258)	(11,652)	**(2,176)**	
Estimated balance to pay	5,834	1,480	2,095	2,643	4,456	6,005	9,700	16,321	11,916	60,450

Net

Underwriting year	2010 and prior years £m	2011 £m	2012 £m	2013 £m	2014 £m	2015 £m	2016 £m	2017 £m	**2018 £m**	Total £m
At end of underwriting year		7,754	6,786	6,222	6,292	5,950	7,473	10,139	**9,438**	
One year later		12,726	11,445	11,735	11,893	12,373	15,680	17,868		
Two years later		12,746	11,668	11,811	12,476	12,987	16,610			
Three years later		12,724	11,512	11,512	12,424	13,646				
Four years later		12,736	11,319	11,363	12,991					
Five years later		12,308	11,248	11,630						
Six years later		12,215	11,558							
Seven years later		12,648								
Cumulative payments		(11,531)	(9,919)	(9,568)	(9,738)	(9,136)	(9,869)	(7,962)	**(1,856)**	
Estimated balance to pay	4,099	1,117	1,639	2,062	3,253	4,510	6,741	9,906	7,582	40,909

4. Risk management *continued*

Financial risk

Credit risk

Credit risk is the exposure to loss if a counterparty fails to perform its contractual obligations.

As discussed on page 48, the market's principal credit risk is that the reinsurance purchased to protect the syndicate's gross losses does not respond as expected. Syndicates are also exposed to credit risk in their premium debtors. Credit risk in respect of premium debt is controlled through broker approval and regular monitoring of premium settlement performance. Syndicates and members are exposed to credit risks in their investment portfolios. PRA and Lloyd's investment guidelines are designed to mitigate credit risk by ensuring diversification of holdings.

The carrying amount of financial assets and reinsurance assets represents the maximum credit risk exposure.

The tables below show the maximum exposure to credit risk for the components of the balance sheet. The maximum exposure is shown gross, before the effect of mitigation through collateral agreements and the use of credit derivatives.

2018	**Neither past due nor impaired £m**	**Past due £m**	**Impaired £m**	**Total £m**
Debt securities	41,679	–	–	**41,679**
Participation in investment pools	2,254	–	–	**2,254**
Loans with credit institutions	3,994	–	–	**3,994**
Deposits with credit institutions	3,806	–	–	**3,806**
Derivative assets	37	–	–	**37**
Other investments	43	–	–	**43**
Reinsurers' share of claims outstanding	19,549	–	(8)	**19,541**
Cash at bank and in hand, including letters of credit and bank guarantees	10,877	–	–	**10,877**
Total	**82,239**	**–**	**(8)**	**82,231**

2017	Neither past due nor impaired £m	Past due £m	Impaired £m	Total £m
Debt securities	37,193	–	4	**37,197**
Participation in investment pools	2,118	–	–	**2,118**
Loans with credit institutions	1,050	–	–	**1,050**
Deposits with credit institutions	5,791	–	–	**5,791**
Derivative assets	75	–	–	**75**
Other investments	60	–	–	**60**
Reinsurers' share of claims outstanding	16,811	–	–	**16,811**
Cash at bank and in hand, including letters of credit and bank guarantees	12,137	–	–	**12,137**
Total	**75,235**	**–**	**4**	**75,239**

In aggregate there are no financial assets that would be past due, or impaired whose terms have been renegotiated, held by syndicates, the Society or within FAL.

In aggregate there were no material debt and fixed income assets held that were past due or impaired beyond their reported fair values, either for the current period under review or on a cumulative basis. For the current period and prior period, in aggregate there were no material defaults on debt securities.

Assets held as collateral comprise cash and debt securities received as collateral against reinsurance assets transferred from syndicates' reinsurers.

The table below provides information regarding the credit risk exposure at 31 December 2018 by classifying assets according to the credit ratings of the counterparties. AAA is the highest possible rating. Assets that fall outside the range of AAA to BBB are classified as other. Debtors, other than amounts due from reinsurers, have been excluded from the table as these are not rated. This table is the sum of assets neither past due nor impaired.

2018	**Rated AAA £m**	**Rated AA £m**	**Rated A £m**	**Rated BBB £m**	**Other £m**	**Total £m**
Debt securities	11,900	9,988	10,543	5,421	3,827	**41,679**
Participation in investment pools	128	131	36	7	1,952	**2,254**
Loans with credit institutions	613	88	171	151	2,971	**3,994**
Deposits with credit institutions	1,740	570	502	248	746	**3,806**
Derivative assets	–	–	8	–	29	**37**
Other investments	9	1	–	–	33	**43**
Reinsurers' share of claims outstanding	616	3,791	12,752	107	2,283	**19,549**
Cash at bank and in hand	250	1,751	7,973	383	520	**10,877**
Total credit risk	**15,256**	**16,320**	**31,985**	**6,317**	**12,361**	**82,239**

2017	Rated AAA £m	Rated AA £m	Rated A £m	Rated BBB £m	Other £m	Total £m
Debt securities	9,379	10,143	9,514	4,827	3,330	**37,193**
Participation in investment pools	187	66	130	8	1,727	**2,118**
Loans with credit institutions	473	76	126	54	321	**1,050**
Deposits with credit institutions	1,592	554	508	257	2,880	**5,791**
Derivative assets	–	1	5	5	64	**75**
Other investments	33	5	–	–	22	**60**
Reinsurers' share of claims outstanding	278	3,868	10,781	40	1,844	**16,811**
Cash at bank and in hand	176	2,207	8,811	478	465	**12,137**
Total credit risk	**12,118**	**16,920**	**29,875**	**5,669**	**10,653**	**75,235**

Liquidity risk

Liquidity risk arises where there are insufficient funds to meet liabilities, particularly claims. Managing agents are expected to manage the cash needs of their syndicates on an ongoing basis and to avoid becoming forced sellers of assets. They are required to match the duration of their syndicates' investments with the liabilities to policyholders. Generally, syndicates have a high concentration of liquid assets, namely cash and government securities.

The Corporation centrally monitors syndicate liquidity, both in terms of asset mix and future funding needs, and conducts stress tests to monitor the impact on liquidity of significant claims events.

4. Risk management *continued*

The table below summarises the maturity profile of financial liabilities for the market.

2018	No stated maturity £m	0-1 yrs £m	1-3yrs £m	3-5yrs £m	>5 yrs £m	Total £m
Claims outstanding	2	19,619	22,149	9,428	9,252	**60,450**
Derivatives	–	31	–	–	–	**31**
Deposits received from reinsurers	26	104	30	7	2	**169**
Creditors	788	8,317	963	145	117	**10,330**
Other liabilities	1	36	3	1	–	**41**
Subordinated debt	–	–	–	–	794	**794**
Total	**817**	**28,107**	**23,145**	**9,581**	**10,165**	**71,815**

2017	No stated maturity £m	0-1 yrs £m	1-3yrs £m	3-5yrs £m	>5 yrs £m	Total £m
Claims outstanding	1	18,410	19,890	8,328	8,264	**54,893**
Derivatives	–	20	–	–	–	**20**
Deposits received from reinsurers	31	61	12	7	–	**111**
Creditors	758	6,805	792	153	137	**8,645**
Other liabilities	6	33	–	–	–	**39**
Subordinated debt	–	–	–	–	793	**793**
Total	**796**	**25,329**	**20,694**	**8,488**	**9,194**	**64,501**

Market risk – overview

Market risk is the risk that the value of financial instruments will fluctuate because of movements in foreign currency, interest rates or asset values. Syndicate assets are held in premium trust funds and are subject to the asset rules contained in the PRA's handbook. Managing agents manage asset risk through their investment strategy.

There is greater oversight of market risk in light of the volatile economic climate, which includes the monitoring of Investment Management Minimum Standards. Lloyd's Financial Risk Committee monitors assets across the full chain of security to ensure the asset disposition of the market and Society remains appropriate, closely monitoring global economic and market trends.

The potential financial impact of changes in market value is additionally monitored through the capital setting process, and asset mix must be reported to the Corporation on a quarterly basis, including credit rating analysis of fixed income portfolios.

Market risk comprises three types of risk:

(a) currency risk;
(b) interest rate risk; and
(c) equity price risk.

Currency risk

Managing agents must identify the main currencies in which each syndicate transacts its business. For the market overall, the US dollar is the largest currency exposure. Assets are then held in each of those currencies to match the relevant liabilities. Managing agents must ensure that assets match liabilities and take corrective action where a mismatch arises. The Corporation also reviews the matching of assets to liabilities at the syndicate level as well as at the market level. In addition, many members seek to match their capital disposition by currency against their peak exposures.

The profile of the aggregate of the Lloyd's market assets and liabilities, categorised by currency at their translated carrying amounts was as follows:

2018	**Sterling £m**	**US dollar £m**	**Euro £m**	**Canadian $ £m**	**Australian $ £m**	**Other £m**	**Total £m**
Financial investments	9,743	40,258	2,640	5,061	1,758	903	**60,363**
Reinsurers' share of technical provisions	3,903	17,055	1,354	688	236	158	**23,394**
Insurance and reinsurance receivables	2,869	12,399	935	425	269	254	**17,151**
Cash at bank and in hand	3,360	6,072	724	323	134	264	**10,877**
Other assets	1,416	3,770	615	257	100	65	**6,223**
Total assets	**21,291**	**79,554**	**6,268**	**6,754**	**2,497**	**1,644**	**118,008**
Technical provisions	15,169	50,449	6,280	3,829	1,590	1,001	**78,318**
Insurance and reinsurance payables	1,311	5,532	573	286	103	72	**7,877**
Other liabilities	2,834	1,872	(139)	156	40	(378)	**4,385**
Total liabilities	**19,314**	**57,853**	**6,714**	**4,271**	**1,733**	**695**	**90,580**
Total capital and reserves	**1,977**	**21,701**	**(446)**	**2,483**	**764**	**949**	**27,428**

2017	Sterling £m	US dollar £m	Euro £m	Canadian $ £m	Australian $ £m	Other £m	Total £m
Financial investments	10,257	35,675	2,890	4,804	1,595	544	**55,765**
Reinsurers' share of technical provisions	3,443	14,977	876	611	225	51	**20,183**
Insurance and reinsurance receivables	2,547	10,598	774	453	228	203	**14,803**
Cash at bank and in hand	4,511	6,107	765	237	221	296	**12,137**
Other assets	1,238	3,704	472	258	84	(248)	**5,508**
Total assets	**21,996**	**71,061**	**5,777**	**6,363**	**2,353**	**846**	**108,396**
Technical provisions	13,942	46,286	5,089	3,785	1,506	662	**71,270**
Insurance and reinsurance payables	1,011	5,078	363	302	68	62	**6,884**
Other liabilities	1,770	1,846	(1)	21	10	(171)	**3,475**
Total liabilities	**16,723**	**53,210**	**5,451**	**4,108**	**1,584**	**553**	**81,629**
Total capital and reserves	**5,273**	**17,851**	**326**	**2,255**	**769**	**293**	**26,767**

4. Risk management *continued*

Sensitivity analysis

A 10% strengthening or weakening of the pound sterling against the following currencies at 31 December would have increased/(decreased) the result before tax and members' balances for the financial year by the amounts shown below. This analysis assumes that all other variables, in particular interest rates, remain constant.

2018	**Impact on result before tax £m**	**Impact on members' balances £m**
Strengthening of US dollar	421	2,586
Weakening of US dollar	(345)	(2,116)
Strengthening of euro	(85)	(44)
Weakening of euro	70	36

2017	Impact on result before tax £m	Impact on members' balances £m
Strengthening of US dollar	257	2,061
Weakening of US dollar	(211)	(1,686)
Strengthening of euro	(18)	40
Weakening of euro	15	(33)

The impact on the result before tax is different to the impact on members' balance as the calculation of the notional return on members' funds at Lloyd's is not affected by currency movements.

Interest rate risk

Interest rate risk is the risk that the value and future cash flows of a financial instrument will fluctuate because of changes in interest rates. Lloyd's operates a generally conservative investment strategy with material cash and short-dated bonds portfolios, which reduces the interest rate risk exposure.

The analysis below is performed for reasonably possible movements in interest rates with all other variables held constant, showing the impact on the result before tax and equity of the effects of changes in interest rates.

2018	**Impact on result before tax £m**	**Impact on members' balances £m**
+ 50 basis points	(344)	(484)
- 50 basis points	339	479

2017	Impact on result before tax £m	Impact on members' balances £m
+ 50 basis points	(351)	(445)
- 50 basis points	347	440

Equity price risk

Equity price risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices (other than those arising from interest rate risk or currency risk), whether those changes are caused by factors specific to the individual financial instrument or its issuer, or factors affecting all similar financial instruments traded in the market.

Equity price risk exposure relates to financial assets and financial liabilities whose values will fluctuate as a result of changes in market prices, principally investment securities.

Such risks are managed by setting and monitoring objectives and constraints on investments, diversification plans and limits on investments in each sector and market.

In aggregate there is no significant concentration of equity price risk.

The analysis below is performed for reasonably possible movements in market indices on financial instruments with all other variables held constant, showing the impact on the result before tax due to changes in fair value of financial assets and liabilities (whose fair values are recorded in the profit and loss account) and members' balances (that reflects adjustments to the result before tax and changes in fair value of available for sale financial assets that are equity instruments).

2018	**Impact on result before tax £m**	**Impact on members' balances £m**
5% increase in equity markets	106	281
5% decrease in equity markets	(106)	(281)

2017	Impact on result before tax £m	Impact on members' balances £m
5% increase in equity markets	107	280
5% decrease in equity markets	(107)	(280)

Concentration risk

The Corporation closely monitors concentrations of risk across the market and tests risk exposure against clearly defined risk appetites as established by the Board. Specialist supervisory teams across the Corporation monitor concentrations across the following areas: region perils, line of business, geographical location, method of distribution in insurance and investment counterparties, among others.

While syndicates define the type of business that they write, at the market level the Corporation seeks to avoid an inappropriate concentration of premium sources, monitoring concentration of business in poorly performing lines, material sources of premium by method of placement as well as coverholder concentration, which feature in metrics reported quarterly to the Board. Managing agents controlling more than 10% of overall market gross written premium are also subject to Board review. Any reported metrics outside of appetite are reported to and discussed by the Risk Committee and the Board. Specific and targeted actions can then be agreed, which will be discussed with specific managing agents or the market as a whole, as appropriate. These actions can vary considerably depending on the nature of the risk or the line of business impacted, with different levels of the requirements placed on syndicates, which forms part of the Corporation's oversight role of the market.

Further analysis of premiums, claims, expenses and underwriting result by line of business is included within note 9 of the PFFS, with commentary on the performance of each line of business included on pages 28-35. Analysis of premium by geographical region is included both within note 9 of the PFFS (which details where contracts were concluded) as well as within the Lloyd's line of business breakdown by region analysis in the "2018 At a Glance" section at the beginning of the Annual Report. Analysis of capital providers by source and location is also included in the "2018 At a Glance" section of the Annual Report. Analysis of investments held within the market is disclosed in note 13 of the PFFS.

4. Risk management *continued*

Regulatory risk

Regulatory risk is the risk of loss owing to a breach of regulatory requirements or failure to respond to regulatory change. Managing agents monitor regulatory development to ensure ongoing compliance and any impact on claims reserves. Additionally, given current developments in the global regulatory landscape, the Corporation closely monitors changes that may adversely impact the global licence network.
The Corporation is actively working with the market to assist and adapt to the changes in the UK regulatory architecture, in particular the increased focus on conduct risk by the Financial Conduct Authority; managing agents are now expected to comply with the Lloyd's Conduct Minimum Standards. Similarly, the Corporation monitors global political trends and is taking action at both a market and Society level in response to a growing geopolitical risk facing companies operating around the world.

Operational risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events. Managing agents manage these risks through internal compliance monitoring and the use of detailed procedure manuals. The Corporation sets minimum standards to be applied by agents and monitors to ensure these are met.

Group risk

Group risk is the risk of loss resulting from risk events arising within a related entity. While Lloyd's is not a group, the Corporation monitors potential risks that could impact Lloyd's, for example arising from the activities of a parent company of a syndicate or managing agent. While, by its nature, group risk is difficult to control, the Corporation mitigates the potential impact of group risk through the implementation of controls, including Lloyd's minimum standards, mitigating any material impairment to Lloyd's brand, reputation or strategic priorities.

5. Variability

Calendar year movements in reserves are based upon best estimates as at 31 December 2018, taking into account all available information as at the balance sheet date. These estimates are subject to variability until the date at which the underlying claims are settled. Such changes in best estimate are reflected in the technical account of the year in which they occur. The aggregate of the prior year surpluses/deficiencies is a surplus of £976m (2017: £706m). The surplus arises across all lines of business, except for the marine line of business, reflecting favourable claims development compared with projections in these classes.

6. Members' funds at Lloyd's (FAL)

The valuation of members' FAL in the balance sheet totals £26,483m (2017: £24,579m). The notional investment return on FAL included in the non-technical profit and loss account totals £178m (2017: £722m).

The notional investment return on FAL has been calculated by applying quarterly yields from indices, net of management fees, to the value of FAL at the beginning of each quarter except, where the Society is the investment manager for FAL, in which case the actual return achieved has been included. A significant proportion of FAL investments are US dollar denominated and, for these assets, US dollar yields from indices are applied.

The following table shows the indices used and the return applied for the full year.

		Proportion of FAL		Investment return	
Investment type	Index	**December 2018 %**	December 2017 %	**2018 %**	2017 %
UK equities	FTSE All share	**4.1**	4.9	**(9.9)**	12.0
UK government bonds	UK Gilts 1-3 years	**2.1**	2.1	**0.1**	(0.6)
UK corporate bonds	UK Corporate 1-3 years	**4.4**	5.0	**0.2**	(0.4)
UK deposits managed by Lloyd's	Return achieved	**4.6**	3.8	**1.8**	0.5
UK deposits managed externally including letters of credit	GBP LIBID 1 month	**12.1**	18.5	**0.3**	0.0
US equities	S&P 500 Index	**8.1**	9.9	**(2.7)**	19.7
US government bonds	US Treasuries 1-5 years	**15.5**	12.8	**1.5**	0.5
US corporate bonds	US Corporate 1-5 years	**25.5**	17.8	**1.2**	1.9
US deposits managed by Lloyd's	Return achieved	**5.8**	5.1	**7.7**	3.7
US deposits managed externally including letters of credit	USD LIBID 1 month	**17.8**	20.1	**1.7**	0.8

7. Society of Lloyd's (the Society)

The results of the Group financial statements of the Society included in the profit and loss account are a profit of £460m (2017: £442m) in the technical account and a loss of £266m (2017: a loss of £257m) in the non-technical account.

8. Aggregation of results and net assets

A reconciliation between the results, statement of other comprehensive income and net assets reported in the syndicate annual accounts, members' FAL and by the Society is set out below:

Profit and loss account	2018 £m	2017 £m
Result per syndicate annual accounts	(1,373)	(2,908)
Result of the Society	163	156
Central Fund claims and provisions incurred in Society financial statements	–	–
Taxation charge in the Society financial statements	39	31
Notional investment return on members' funds at Lloyd's	178	722
Movement in Society income not accrued in syndicate annual accounts	(8)	(2)
Result for the financial year before tax	**(1,001)**	**(2,001)**

Capital and reserves	2018 £m	2017 £m
Net assets per syndicate annual accounts	(1,475)	(1)
Net assets of the Society	2,417	2,188
Central Fund claims and provisions	–	–
Members' funds at Lloyd's	26,483	24,579
Unpaid cash calls reanalysed from debtors to members' balances	40	30
Society income receivable not accrued in syndicate annual accounts	(37)	(29)
Total capital and reserves	**27,428**	**26,767**

Transactions between syndicates and the Society (which have been reported within both the syndicate annual accounts and the Society financial statements) have been eliminated in the PFFS as set out in note 2.

Notes to the Pro Forma Financial Statements *continued*

(For the year ended 31 December 2018)

9. Segmental analysis

The syndicate returns to the Corporation provided additional information to derive the following table in respect of the lines of business reviewed in the market commentary.

2018	Gross written premiums £m	Net earned premium £m	Net incurred claims £m	Net operating expenses £m	Under-writing result £m
Reinsurance	11,070	7,650	(5,524)	(2,582)	**(456)**
Property	9,687	6,692	(4,319)	(3,073)	**(700)**
Casualty	9,094	6,363	(3,696)	(2,850)	**(183)**
Marine	2,603	2,154	(1,580)	(917)	**(343)**
Energy	1,404	897	(392)	(392)	**113**
Motor	1,037	940	(607)	(321)	**12**
Aviation	549	410	(292)	(167)	**(49)**
Life	83	72	(28)	(28)	**16**
Total from syndicate operations	**35,527**	**25,178**	**(16,438)**	**(10,330)**	**(1,590)**
Transactions between syndicates and the Society (notes 2 and 7) and insurance operations of the Society				460	**460**
PFFS premiums and underwriting result	**35,527**	**25,178**	**(16,438)**	**(9,870)**	**(1,130)**
Allocated investment return transferred from the non-technical account					**367**
Balance on the technical account for general business					**(763)**

2017	Gross written premiums £m	Net earned premium £m	Net incurred claims £m	Net operating expenses £m	Under-writing result £m
Reinsurance	10,560	7,751	(6,498)	(2,583)	**(1,330)**
Property	8,965	6,367	(5,137)	(2,987)	**(1,757)**
Casualty	8,464	6,082	(3,558)	(2,713)	**(189)**
Marine	2,506	2,092	(1,674)	(887)	**(469)**
Energy	1,253	783	(277)	(401)	**105**
Motor	1,057	843	(723)	(308)	**(188)**
Aviation	687	509	(320)	(200)	**(11)**
Life	99	71	(63)	(32)	**(24)**
Total from syndicate operations	**33,591**	**24,498**	**(18,250)**	**(10,111)**	**(3,863)**
Transactions between syndicates and the Society (notes 2 and 7) and insurance operations of the Society				442	**442**
PFFS premiums and underwriting result	**33,591**	**24,498**	**(18,250)**	**(9,669)**	**(3,421)**
Allocated investment return transferred from the non-technical account					**732**
Balance on the technical account for general business					**(2,689)**

The geographical analysis of direct insurance premiums by location where contracts were concluded is as follows:

	2018 £m	2017 £m
United Kingdom	**24,063**	22,651
Other EU member states	**38**	29
Rest of the World	**356**	351
	24,457	**23,031**

10. Life business

The PFFS include the results of all life and non-life syndicates transacting business during 2018. The results and net assets for life syndicates are not material and have not been separately disclosed in the profit and loss account and balance sheet. The results for life business are reported in the segmental analysis (note 9).

11. Net operating expenses

	2018 £m	2017 £m
Acquisition costs	9,033	8,645
Change in deferred acquisition costs	(171)	(239)
Administrative expenses	2,270	2,307
Reinsurance commissions and profit participation	(1,262)	(1,044)
	9,870	**9,669**

Total commissions on direct insurance business accounted for in the year amounted to £6,100m (2017: £5,773m).

12. Investment return

Interest and similar income	2018 £m	2017 £m
From financial instruments designated as at fair value through profit or loss	836	1,356
From available for sale investments	39	35
From financial instruments designated as held to maturity	–	1
Dividend income	48	37
Interest on cash at bank	50	23
Other interest and similar income	30	35
Investment expenses	(45)	(72)
Total	**958**	**1,415**

Other income from investments designated as at fair value through profit or loss	2018 £m	2017 £m
Realised gains/(losses)	(17)	261
Unrealised gains/(losses)	(464)	89
Other relevant income/(losses)	27	35
Total	**(454)**	**385**

Total investment return	**504**	**1,800**

13. Financial investments

	2018 £m	2017 £m
Shares and other variable yield securities	8,550	9,474
Debt securities and other fixed income securities	41,679	37,197
Participation in investment pools	2,254	2,118
Loans and deposits with credit institutions	7,800	6,841
Other investments	80	135
	60,363	**55,765**

Disclosures of fair values in accordance with the fair value hierarchy

Fair value measurements have been classified using a fair value hierarchy that reflects the significance of the inputs used in making the measurements.

The fair value hierarchy includes the following classifications:

- Level 1 – Quoted prices (unadjusted) in active markets for identical assets. An active market is one in which transactions for the asset occur with sufficient frequency and volume to provide readily and regularly available quoted prices;
- Level 2 – Inputs to a valuation model other than quoted prices included within Level 1 that are observable for the asset, either directly (ie as prices) or indirectly (derived from prices); and
- Level 3 – Inputs to a valuation model for the asset that are not based on observable market data (unobservable inputs) and are significant to the overall fair value measurement. Unobservable inputs may have been used to measure fair value to the extent that observable inputs are not available, thereby allowing for situations in which there is little, if any, market activity for the asset at the measurement date (or market information for the inputs to any valuation models). As such, unobservable inputs reflect the assumptions it is considered that market participants would use in pricing the asset.

The level in the fair value hierarchy within which the fair value measurement is categorised in its entirety is determined on the basis of the lowest level input that is significant to the fair value measurement. The significance of an input is assessed against the fair value measurement in its entirety. If a fair value measurement uses observable inputs that require significant adjustment based on unobservable inputs, that measurement is a Level 3 measurement. Assessing the significance of a particular input to the fair value measurement in its entirety requires judgement, considering factors specific to the asset.

2018	Level 1 £m	Level 2 £m	Level 3 £m	Sub-total fair value £m	Assets held at amortised cost £m	Total £m
Shares and other variable yield securities	3,546	4,229	774	8,549	1	8,550
Debt and other fixed income securities	14,087	27,572	20	41,679	–	41,679
Participation in investment pools	2,013	222	19	2,254	–	2,254
Loans and deposits with credit institutions	4,232	3,400	168	7,800	–	7,800
Other investments	9	46	25	80	–	80
Total investments	**23,887**	**35,469**	**1,006**	**60,362**	**1**	**60,363**
Loans recoverable	–	–	36	36	–	36
Total assets	**23,887**	**35,469**	**1,042**	**60,398**	**1**	**60,399**
Borrowings	(4)	–	(14)	(18)	–	(18)
Derivative liabilities	(10)	(20)	(1)	(31)	–	(31)
Total liabilities	**(14)**	**(20)**	**(15)**	**(49)**	**–**	**(49)**

Loans recoverable represent loans made to hardship members by the Central Fund, with further details disclosed in the Society Report (note 2 and note 16).

2017	Level 1 £m	Level 2 £m	Level 3 £m	Sub-total fair value £m	Assets held at amortised cost £m	Total £m
Shares and other variable yield securities	3,797	4,865	811	9,473	1	9,474
Debt and other fixed income securities	12,094	25,022	81	37,197	–	37,197
Participation in investment pools	1,875	211	32	2,118	–	2,118
Loans and deposits with credit institutions	3,325	3,333	181	6,839	2	6,841
Other investments	6	100	29	135	–	135
Total investments	**21,097**	**33,531**	**1,134**	**55,762**	**3**	**55,765**
Loans recoverable	–	–	43	43	–	43
Total assets	**21,097**	**33,531**	**1,177**	**55,805**	**3**	**55,808**
Borrowings	(11)	–	–	(11)	–	(11)
Derivative liabilities	(1)	(19)	–	(20)	–	(20)
Total liabilities	**(12)**	**(19)**	**–**	**(31)**	**–**	**(31)**

14. Debtors arising out of direct operations

	2018 £m	2017 £m
Due within one year		
— Policyholders	1	1
— Intermediaries	9,569	8,781
Due after one year		
— Policyholders	–	–
— Intermediaries	103	100
Total	**9,673**	8,882

15. Debtors arising out of reinsurance operations

	2018 £m	2017 £m
Due within one year	6,659	5,245
Due after one year	819	676
Total	**7,478**	5,921

16. Cash at bank and in hand

Cash at bank and in hand includes letters of credit and bank guarantees held in trust within members' FAL to meet policyholder claims as required, totalling £8,012m (2017: £9,463m).

17. Members' balances

	2018 £m	2017 £m
Balance at 1 January	–	4,015
Result for the year per syndicate annual accounts	(1,373)	(2,908)
Distribution on closure of the 2015 (2014) year of account	(1,656)	(2,670)
Advance distributions from open years of account	(29)	(60)
Movement in cash calls	834	1,041
Net movement on funds in syndicate (see note below)	825	774
Exchange (losses)/gains	(50)	(116)
Other	(23)	(76)
Balance at 31 December	**(1,472)**	–

Members participate on syndicates by reference to years of account. Members' ultimate results, assets and liabilities are assessed by year of account with reference to policies incepting in that year of account. Members' balances represent the net profit/(loss) to be distributed/(collected) by syndicates to/(from) the members. Where there are profits and funds at Lloyd's held in excess of members' capital requirements, they will be distributed in the second quarter of 2019.

Members that only participate on one syndicate may hold the capital supporting their underwriting in their syndicate's premium trust funds. These funds are known as funds in syndicate (FIS). At 31 December 2018 there was £5,053m (2017: £4,076m) of FIS within members' balances. Where a member takes advantage of this facility in the year, the movement is reflected in the above table as "net movement on funds in syndicate".

18. Technical provisions

(a) Provisions for unearned premiums

2018	Gross £m	Reinsurers' share £m	Net £m
At 1 January	16,377	3,372	13,005
Premiums written in the year	35,527	9,846	25,681
Premiums earned in the year	(34,738)	(9,560)	(25,178)
Exchange movements	702	195	507
At 31 December	**17,868**	**3,853**	**14,015**

2017	Gross £m	Reinsurers' share £m	Net £m
At 1 January	16,548	3,110	13,438
Premiums written in the year	33,591	8,722	24,869
Premiums earned in the year	(32,744)	(8,246)	(24,498)
Exchange movements	(1,018)	(214)	(804)
At 31 December	**16,377**	**3,372**	**13,005**

(b) Deferred acquisition costs

	2018 £m	2017 £m
At 1 January	4,304	4,278
Change in deferred acquisition costs	171	239
Exchange movements	173	(232)
Other	32	19
At 31 December	**4,680**	**4,304**

(c) Claims outstanding

2018	Gross £m	Reinsurers' share £m	Net £m
At 1 January	54,893	16,811	38,082
Claims paid during the year	(19,666)	(5,682)	(13,984)
Claims incurred during the year	24,561	8,123	16,438
Exchange/other movements	662	289	373
At 31 December	**60,450**	**19,541**	**40,909**

2017	Gross £m	Reinsurers' share £m	Net £m
At 1 January	47,747	11,310	36,437
Claims paid during the year	(18,292)	(3,634)	(14,658)
Claims incurred during the year	28,060	9,810	18,250
Exchange/other movements	(2,622)	(675)	(1,947)
At 31 December	**54,893**	**16,811**	**38,082**

19. Discounted claims

Discounting may be applied to claims provisions where there are individual claims with structured settlements that have annuity-like characteristics or for books of business with mean term payment greater than four years. Certain syndicates have elected to discount their claims provisions.

The claims have been discounted as follows:

	Average discounted rates		Average mean term of liabilities	
Line of business	**2018 %**	2017 %	**2018 years**	2017 years
Motor (third party liability)	2.41	2.46	26.12	24.55
Motor (other classes)	2.98	3.00	2.29	2.60
Third party liability	2.57	2.32	22.45	22.96

The period that will elapse before claims are settled is determined using impaired mortality rates.

The claims provisions before discounting are as follows:

	Before discounting		Effect of discounting		Discounted provision	
	2018 £m	2017 £m	**2018 £m**	2017 £m	**2018 £m**	2017 £m
Total claims provisions	1,429	1,649	(333)	(430)	1,096	1,219
Reinsurers' share of total claims	398	549	(63)	(78)	335	471

Notes to the Pro Forma Financial Statements *continued*

(For the year ended 31 December 2018)

20. Creditors arising out of direct insurance operations

	2018 £m	2017 £m
Due within one year	1,322	953
Due after one year	3	2
	1,325	**955**

21. Creditors arising out of reinsurance operations

	2018 £m	2017 £m
Due within one year	5,884	5,332
Due after one year	668	597
	6,552	**5,929**

22. Note to the statement of cash flows

Cash and cash equivalents comprise the following:

	2018 £m	2017 £m
Cash at bank and in hand	10,877	12,137
Short term deposits with credit institutions	1,731	2,146
Overdrafts	(213)	(170)
	12,395	**14,113**

Of the cash and cash equivalents, £326m (2017: £548m) is held in regulated bank accounts in overseas jurisdictions.

23. Five year summary

Results	2018 £m	2017 £m	2016 £m	2015 £m	2014 £m
Gross written premiums	**35,527**	33,591	29,862	26,690	25,259
Net written premiums	**25,681**	24,869	23,066	21,023	20,006
Net earned premiums	**25,178**	24,498	22,660	20,565	19,499
Result attributable to underwriting	**(1,130)**	(3,421)	468	2,047	2,253
Result for the year before tax	**(1,001)**	(2,001)	2,107	2,122	3,016
Assets employed					
Cash and investments	**71,240**	67,902	67,646	56,900	54,889
Net technical provisions	**54,924**	51,087	49,875	41,578	40,025
Other net assets	**11,112**	9,952	9,943	8,894	7,664
Capital and reserves	**27,428**	**26,767**	**27,714**	**24,216**	**22,528**
Statistics					
Combined ratio (%)	**104.5**	114.0	97.9	90.0	88.4
Return on capital (%)	**(3.7)**	(7.3)	8.1	9.1	14.1

24. Related party transactions

The annual accounts of each syndicate provide, where appropriate, the required disclosures on related parties. Syndicate level disclosures are specific to that syndicate and its managing agent. For 2018, there were no material related party transactions conducted outside normal market conditions reported in the syndicate annual accounts requiring disclosure. The related party transactions of the Society are disclosed in note 27 on page 180.

Managing Agents and Syndicates

Managing Agent	Managed Syndicate(s)	2018 GWP* £m	2018 Result £m	2018 Combined Ratio* %
Advent Underwriting Limited	780	185	(16)	123%
AEGIS Managing Agency Limited	1225	555	28	97%
Allied World Managing Agency Limited	2232	225	3	101%
AmTrust Syndicates Limited	44	18	(1)	107%
	779	6	(1)	127%
	1206	53	(15)	113%
	1861	616	2	101%
	2526	–	5	739%
	5820	69	3	99%
Antares Managing Agency Limited	1274	438	(32)	108%
Apollo Syndicate Management Limited	1969	313	(45)	126%
	6133	44	(21)	192%
Arch Underwriting at Lloyd's Ltd	2012	232	(1)	98%
Argenta Syndicate Management Limited	2121	398	(38)	114%
	6134	31	(3)	120%
Argo Managing Agency Limited	1200	589	(36)	108%
	1910	364	8	95%
	6117	83	3	96%
Ark Syndicate Management Limited	3902	97	–	101%
	4020	269	(13)	105%
Ascot Underwriting Limited	1414	680	44	91%
Aspen Managing Agency Limited	4711	388	(25)	111%
Asta Managing Agency Limited	1729	128	(3)	104%
	1897	68	(15)	121%
	1980	188	(30)	176%
	2357	443	(125)	161%
	2525	70	9	83%
	2689	102	(13)	116%
	2786	116	(12)	108%
	3268	89	(19)	151%
	4242	160	(55)	168%
	5886	148	(17)	118%
	6123	19	(11)	235%
	6126	3	(8)	148%
	6131	3	(1)	193%
Atrium Underwriters Limited	609	503	33	93%
AXIS Managing Agency Limited	1686	313	(32)	118%
	2007	946	(87)	116%
	6129	72	(52)	224%
Barbican Managing Agency Limited	1856	144	(7)	106%
	1955	434	(10)	110%
	6118	143	(7)	109%
	6132	40	(3)	121%
Beaufort Underwriting Agency Limited	318	177	(56)	136%
Beazley Furlonge Limited	623	357	6	97%
	2623	1,625	69	96%
	3622	18	2	89%
	3623	(25)	(8)	118%
	5623	6	–	106%

Managing Agents and Syndicates *continued*

Managing Agent	Managed Syndicate(s)	2018 GWP* £m	2018 Result £m	2018 Combined Ratio* %
Beazley Furlonge Limited (continued)	6050	–	2	70%
	6107	51	(2)	109%
Brit Syndicates Limited	2987	1,655	(48)	105%
	2988	107	(22)	128%
Canopius Managing Agents Limited	4444	1,249	(74)	108%
Capita Managing Agency Limited	1492	130	2	98%
Cathedral Underwriting Limited	2010	217	(24)	119%
	3010	64	1	99%
Catlin Underwriting Agencies Limited	2003	2,261	(250)	116%
	2088	189	(26)	119%
	3002	43	2	93%
	6111	34	(9)	126%
	6112	1	(1)	126%
	6119	–	–	133%
	6121	2	–	118%
Charles Taylor Managing Agency Limited	1884	104	(57)	160%
Chaucer Syndicates Limited	1084	962	(18)	103%
	1176	29	22	31%
	6130	21	1	89%
Chubb Underwriting Agencies Limited	1882	(2)	9	217%
	2488	440	34	90%
Coverys Managing Agency Limited	1110	12	7	79%
	1975	36	(3)	114%
	1991	149	(15)	111%
	3330	–	(3)	703%
Endurance at Lloyd's Limited	5151	358	(9)	107%
ERS Syndicate Management Limited	218	329	11	96%
Faraday Underwriting Limited	435	470	25	98%
Hamilton Underwriting Limited	3334	135	(23)	133%
Hardy (Underwriting Agencies) Limited	382	373	(15)	105%
HCC Underwriting Agency Ltd	4141	161	17	85%
Hiscox Syndicates Limited	33	1,385	99	88%
	3624	338	10	99%
	6104	36	(11)	131%
Liberty Managing Agency Limited	4472	1,386	(7)	99%
Managing Agency Partners Limited	2791	179	9	94%
	6103	17	(1)	109%
Markel Syndicate Management Limited	3000	515	(15)	106%
MS Amlin Underwriting Limited	2001	2,372	(114)	111%
	3210	24	(30)	188%
Munich Re Syndicate Limited	457	523	35	92%
Navigators Underwriting Agency Limited	1221	332	(4)	105%
Neon Underwriting Limited	2468	405	(48)	120%
Newline Underwriting Management Limited	1218	152	(16)	91%
Pembroke Managing Agency Limited	1947	24	(12)	218%

Managing Agent	Managed Syndicate(s)	2018 GWP* £m	2018 Result £m	2018 Combined Ratio* %
Pembroke Managing Agency Limited (continued)	2014	200	(17)	112%
	4000	423	24	95%
	6125	21	(7)	144%
QBE Underwriting Limited	386	351	31	92%
	2999	1,192	26	98%
RenaissanceRe Syndicate Management Limited	1458	564	(6)	103%
RiverStone Managing Agency Ltd	3500	207	6	94%
S.A. Meacock & Company Limited	727	73	11	90%
Sirius International Managing Agency Limited	1945	100	(11)	110%
Starr Managing Agents Limited	1919	297	(4)	110%
StarStone Underwriting Limited	1301	249	(89)	177%
	2008	971	4	99%
Talbot Underwriting Ltd	1183	713	(48)	111%
The Channel Managing Agency Limited	2015	313	(54)	126%
Tokio Marine Kiln Syndicates Limited	308	12	3	87%
	510	1,377	(23)	103%
	557	16	6	59%
	1880	271	1	100%
Travelers Syndicate Management Limited	5000	354	(30)	110%
Vibe Syndicate Management Limited	5678	121	(12)	110%
W R Berkley Syndicate Management Limited	1967	190	(10)	110%
Market level SPA, RITC and aggregation adjustments (note 2, note 8)		(1,699)	372	
Total		**35,527**	**(1,001)**	**104.5%**

* Refer to glossary on page 185 for further information.

The following syndicates ceased trading at 31 December 2018:

AmTrust Syndicates Limited 44
Advent Underwriting Limited 780
Charles Taylor Managing Agency Limited 1884
Axis Managing Agency Limited 2007
Catlin Underwriting Agencies Limited 6111
Barbican Managing Agency Limited 6118
Axis Managing Agency Limited 6129
Chaucer Syndicates Limited 6130

As at 26 March 2019 the following syndicates commenced trading for the 2019 year of account:

Apollo Syndicate Management Limited 1971