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Syndicate 2012

Annual Report and Accounts
For the year ended 31 December 2014

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Strategic Report for the year ended 31 December 2014

The Directors of Arch Underwriting at Lloyd's Ltd ("AUAL", "the Managing Agent") have pleasure in presenting the annual report and financial statements of managed Syndicate 2012 (the "Syndicate") for the year ended 31 December 2014.

The Syndicate is a wholly aligned Syndicate, with underwriting capacity being provided by sole participant Arch Syndicate Investments Ltd.

The ultimate parent company of Arch Syndicate Investments Ltd is Arch Capital Group Ltd ("ACGL"), a Bermuda-based company with $7.03bn (2013: $6.50bn) of capital as at 31 December 2014. Through operations in Bermuda, the United States of America, Europe, Canada, Australia and South Africa, ACGL provides insurance and reinsurance on a worldwide basis. ACGL is listed on the NASDAQ U.S. stock exchange.

Principal Activities

The principal activity of Syndicate 2012 is the underwriting of insurance business at Lloyd's. The Syndicate began trading at Lloyd's on 1 April 2009.

The underwriting strategy is to operate in lines of business in which underwriting expertise can make a meaningful difference to operating results. Our insurance business focuses on talent-intensive rather than labour-intensive business and seeks to operate profitably across all product lines. Syndicate 2012 underwrites at Lloyd's in the wholesale insurance market and through selective delegated underwriting authorities for regional markets. To achieve our objectives our insurance operating principles are to:

- Capitalise on profitable underwriting opportunities;
- Centralise responsibility for underwriting;
- Maintain underwriting discipline throughout the market cycle;
- Focus on providing superior claims management; and
- Utilise broker and managing general agent distribution platforms.

Our underwriting philosophy is to generate an underwriting profit through prudent risk selection and appropriate pricing across all types of business. To achieve this, we encourage adherence to uniform underwriting standards across each product line focusing on: risk selection; desired attachment point; limits and retention management; and underwriting due diligence, including financial condition, claims history, management and exposure; underwriting authority and approval limits.

Syndicate 2012 underwrites the following lines of business:

- Casualty;
- Directors and officers liability;
- Marine;
- Onshore energy
- Professional Lines;
- Property;
- Personal accident; and
- Terrorism

As well as conventional London market business, the Syndicate underwrites a portfolio of SME ("small and medium sized enterprises") based retail business, which remains a focus for the future development of the Syndicate.

The Managing Agent has subsidiary undertakings incorporated in South Africa and Australia. Arch Underwriting Managers at Lloyd's (South Africa) Pty Limited, Resource Underwriting Pacific Pty Limited and Arch Underwriting at Lloyd's (Australia) Pty Limited are licensed to trade as Lloyd's service companies with authority to bind risks on behalf of Syndicate 2012. The focus for 2014 has continued to be the development of infrastructure and portfolios of profitable business.

Strategic Report for the year ended 31 December 2014 *(continued)*

Review of the Business

Despite challenging market conditions the Syndicate recorded an underwriting profit of £1.5m (2013: profit £1.2m) and total recognised profit of £9.2m (2013: loss £2.6m).

	2014 £m	%	2013 £m	%
Gross premiums written	150.6		157.6	
Earned premiums, net of reinsurance	99.6		121.6	
Claims incurred, net of reinsurance	(56.0)	*56.1*	(73.0)	*60.0*
Net operating expenses	(42.1)	*42.3*	(47.4)	*39.0*
Balance on technical account for general business	1.5	*98.4*	1.2	*99.0*
Investment return and foreign exchange	7.7		(3.8)	
Total recognised gains / (losses)	9.2		(2.6)	

Gross Written Premiums

Gross written premiums of £150.6m are 4.4% lower than 2013. During 2014 the Syndicate embarked upon a strategy of deemphasising a number of existing coverholder arrangements within the portfolio, with the longer term objective of building a broader base of in-house SME products. The underwriting conditions have been tough in 2014 and the continued focus for Syndicate 2012 is to write profitable business.

The Syndicate experienced an increase in Property income during 2014. This was a result of underwriting new property binder business in 2014 following the recruitment of a specialist underwriting team.

During 2014 the Syndicate had a decrease in Accident & Health income as well as Marine. Lower premium was primarily due to the soft market environment with higher pressure on rates and increased capacity in the market. The Marine book saw a change of underwriter in 2014 and as well as a change in strategy and approach to the business written. The Syndicate will continue to acquire underwriting teams, when exceptional talent becomes available.

Incurred Claims

The net incurred loss ratio of 56% represent a significant improvement on the 60% reported for the previous financial year. The improvement in performance reflects the absence of catastrophe loss activity during the current accident year, combined with a reduction in the frequency and severity of risk loss activity experienced in prior years.

Underwriting performance has been further supplemented by favourable development from prior accident years. Due to a light incurred claims development on short tail lines the Syndicate has released reserves of £2.3m (2013: £4.5m) from Property. The Syndicate also experienced light incurred claims development and a release of claims provision in prior years in relation to Professional Lines and Accident & Health business, resulting in favourable prior year development of £3.4m (2013: £5.0m) and £2.3m (2013: loss £0.4m) respectively.

Operating Expenses

Net operating expenses of £42.1m (2013: £47.4m) are £5.3m lower than 2013. The principal driver for this reduction is a planned reduced volume of coverholder business which has historically incurred a higher than average acquisition cost. Administrative expenses continue to be in line with expectations.

Non Technical Account

The Syndicate incurred non-technical profit of £6.0m (2013: losses £7.2m). The principal driver behind the performance of the non-technical account was the performance of the investment portfolio.

Strategic Report for the year ended 31 December 2014 *(continued)*

The closing foreign exchange rates used in the financial statements of the Syndicate are as follows:

	2014	2013
US Dollar	1.5593	1.6563
Euro	1.2886	1.2020
Australian Dollar	1.9054	1.8513

Principal Risks and Uncertainties

The following paragraphs describe the principal risks and uncertainties facing the Syndicate and any mitigation taken to limit those risks:

Insurance Risk

Syndicate 2012's insurance business assumes the risk of loss from persons or organisations that are directly exposed to an underlying loss. Insurance risk arises from this risk transfer due to the inherent uncertainties about the occurrence, amount and timing of insurance liabilities. The three key components of insurance risk are; underwriting risk, reserving & claims risk and ceded reinsurance risk. Each element is considered below.

(i) Underwriting risk arises from the:

- Adequacy of the Syndicate's pricing, taking the insurance premium cycle into account and the high level of uncertainty in pricing new or emerging risks, particularly long tail risk;
- Adequacy of the reinsurance programme and whether it is appropriate for the risks selected by the Syndicate and adequately takes account of the underwriting and business plans;
- Prospect of reinsurance rates increasing substantially or reinsurance being unavailable;
- Uncertainty of claims experience;
- Dependence on intermediaries for a disproportionate share of the premium income;
- Geographical and jurisdictional concentrations;
- Appropriateness of policy wordings;
- Risk of mis-selling; and
- Tolerance for variations in expenses (including indirect costs).

The Syndicate seeks to limit its loss exposure by purchasing reinsurance limits up to its maximum line sizes and accumulations and in the case of catastrophes; cover is purchased up to a modelled 1 in 250 year event. The Syndicate also seeks to limit loss exposure by geographic diversification.

For natural catastrophe exposed business, the Syndicate seeks to limit the amount of exposure from any one insured or reinsured and the amount of the exposure to catastrophe losses in any geographic zone.

In common with all insurers, the business written by Syndicate 2012 is exposed to price volatility. However, underwriters are firm in their resolve to reject business that is unlikely to generate underwriting profit and meet return on capital requirements. Additionally, the Syndicate alters its appetite for the lines of business and the layers it writes within them in response to market conditions.

Syndicate 2012 writes significant premium income through agents and coverholders to whom binding authority is given to accept risks on its behalf. This delegation is strictly controlled through tight underwriting guidelines and limits, and extensive monitoring, review and auditing.

(ii) Reserving & Claims Risks arise from:

- The frequency and size of large claims;
- Possible outcomes relating to any disputed claims, particularly where the outcome is subject to legal proceedings;
- The ability of the Syndicate to withstand catastrophic events, increases in unexpected exposures, latent claims or aggregation of claims;
- The possible exhaustion of reinsurance arrangements, both on a per risk and per event basis;
- Social and societal factors driving an increase in the propensity to claim and to sue;
- Other social, economic and technological changes;