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Syndicate 4242

Annual Report and Accounts

31 December 2014

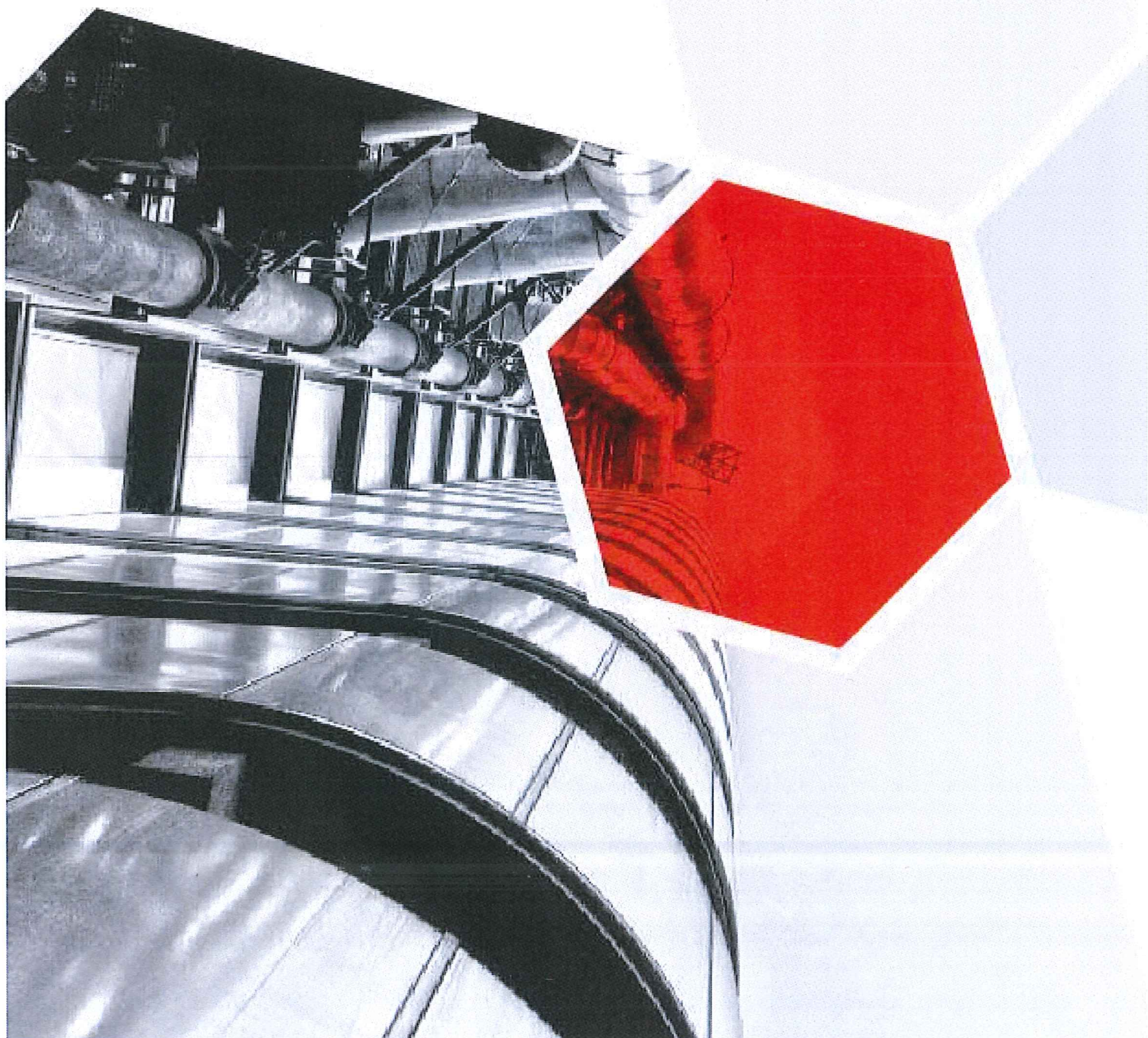


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Directors and Administration

Managing Agent

Managing Agent

Asta Managing Agency Ltd

Directors

T A Riddell, Chairman and Non-Executive Director

Y A Bouman

G M J Erulin, Non-Executive Director

L Harfitt

A J Hubbard, Non-Executive Director

D J G Hunt

D F C Murphy, Non-Executive Director

S P A Norton

J W Ramage, Non-Executive Director

J M Tighe

Company Secretary

C Chow

Managing Agent's Registered Office

5th Floor Camomile Court

23 Camomile Street

London

EC3A 7LL

Registered Number

01918744

Directors and Administration (Continued)

Syndicate

Active Underwriter

M H McConnell

Primary Coverholder

International Catastrophe Insurance Managers LLC (ICAT)

Claims Administrator

Boulder Claims LLC

Investment Manager

General Re – New England Asset Management

Bankers

Citibank NA

Barclays Bank Plc

Lloyds Bank

The Bank of New York Mellon Corporation

Registered Auditors

KPMG LLP

Signing Actuary

P J Tippin, KPMG LLP

Annual Report of the Directors of the Managing Agent

31 December 2014

The directors of the Managing Agent (the directors) present their report below, together with the audited annual accounts for Syndicate 4242 (the Syndicate), for year ended 31 December 2014 on pages 19 to 40.

The directors prepared this annual report using the annual basis of accounting required by Statutory Instruments No. 1950 of 2008, the Insurance Accounts Directive (Lloyd's Syndicate and Aggregate Accounts) Regulations 2008. The directors provide separate accounts for closed underwriting years to the Syndicate's members.

Managing Agent

The Managing Agent for the Syndicate is Asta Managing Agency Ltd (Asta). Asta also manages eight other syndicates on behalf of supporting third parties. The accounts of the Managing Agent can be obtained by application to the Managing Agent's Registered Office listed on page 2.

Results

The Syndicate generated profits of \$32.5 million (\$24.6 million in 2013) on gross written premiums of \$135.2 million (\$125.2 million in 2013).

This table details the profits and related returns on insurance capacity for the 2012 closed underwriting year and the directors forecast for the Syndicate's two open underwriting years.

	Underwriting Years		
	2014	2013	2012
	Open	Open	Closed
	\$000	\$000	\$000
Profit	22,351	27,720	13,528
Return on insurance capacity	16.8%	21.3%	10.9%

Principal Activities

The Syndicate transacts general insurance and reinsurance business in the United Kingdom (U.K.) within the Lloyd's market. The Syndicate specialises in underwriting property insurance policies covering small and middle market businesses located in areas of the United States (U.S.) that are prone to hurricanes and earthquakes. Hurricane policies include coverage for tropical storms and also provide attritional protection against tornados, hail, and other windstorm risks. The Syndicate also offers incidental general liability and limited flood coverage when purchased alongside hurricane or earthquake coverage and All Other Peril (AOP) coverage. AOP coverage provides protection against fires, theft, vandalism, water damage, and other covered property perils. The Syndicate also provides reinsurance to U.S. insurance companies covering personal lines property risks against named hurricanes in Hawaii and earthquakes in California and Hawaii.

The Syndicate contracts with certain wholly owned subsidiaries of Paraline Group, Ltd, a Bermuda based insurance organisation, for certain insurance services; these subsidiaries include International Catastrophe Insurance Managers, LLC (ICAT Managers), Boulder Claims, LLC (Boulder Claims), and Paraline International, Ltd (Paraline International). ICAT Managers and Boulder Claims are Delaware companies, while Paraline International is a Bermuda company.

ICAT Managers underwrites most of the Syndicate's insurance business as its primary coverholder. ICAT Managers writes business for the Syndicate through its network of relationships

Annual Report of the Directors of the Managing Agent (Continued)

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with surplus lines wholesale brokers and licensed retail agents. Although the Syndicate delegates day-to-day underwriting and related operational management responsibility to ICAT Managers, the directors regularly review the results of the coverholder's monitoring procedures and supplement these procedures with Managing Agent and third party audits. Paraline International also provides underwriting oversight for the Syndicate.

Boulder Claims provides claims administration services to the Syndicate. The Managing Agent contracts with a third party to coordinate oversight of Boulder Claims.

The insurance services that ICAT Managers and Boulder Claims (collectively, ICAT) provide to the Syndicate account for 55.6% of their total business. ICAT also provides services to other syndicates and insurance carriers and claims services to a state sponsored risk pool. ICAT's main office is in Broomfield, Colorado.

The Syndicate also contracts with other parties to underwrite insurance business subject to oversight by ICAT.

Business Review

Business Summary

The Syndicate entered into a binding authority agreement with ICAT to underwrite insurance business. ICAT writes this business in the underwriting regions of the U.S. below.

- i. Eastern Seaboard
- ii. Florida
- iii. Gulf Coast
- iv. Hawaii
- v. Earthquake (primarily California, the Pacific Northwest, the Intermountain West, Alaska, the New Madrid area, and Hawaii)

ICAT further divides its underwriting operations into two business units: the Platform Business Unit (PBU) and the Middle Market Business Unit (MMBU).

- i. The PBU provides coverage to small businesses that the traditional insurance industry may overlook having properties with insured values of generally \$5.0 million or less with an average value of \$1.7 million and an average premium of \$5,139. Small business policies account for 49.5% (51.3% in 2013) of the Syndicate's total business.
- ii. The MMBU provides coverage to middle market businesses on the lower end of the market that require customised and layered insurance solutions. Middle market properties have insured values of more than \$5.0 million, but typically less than \$35.0 million, with an average value of \$18.8 million and an average premium of \$17,278. Middle market policies account for 42.4% (43.6% in 2013) of the Syndicate's total business.

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The Syndicate also provides proportional reinsurance to four U.S. insurance companies covering personal lines property risks: three companies covering earthquakes in California and one company covering named hurricanes and earthquakes in Hawaii. The Syndicate reinsures the California risks, most of which are subject to maximums of \$2.5 million for each building and \$4.1 million of total insured value for each policy. The Syndicate also limits its reinsurance acceptances from one company ceding California risks to no more than \$3.5 million of premiums and \$600.0 million of total insured value, while it limits the cessions from another to \$15.0 million of premiums a year. The Syndicate reinsures Hawaii risks, subject to a maximum liability of \$105.0 million for each hurricane (\$210.0 million in the event of multiple hurricanes). These California and Hawaii reinsurance arrangements include commissions of 26.0% to 37.5% on inward reinsurance premiums. These reinsurance acceptances account for 6.9% (4.8% in 2013) of the Syndicate's total business.

The Syndicate has separate binding authority agreements with third party coverholders to underwrite policies covering high-value homes and small businesses against hurricanes in the Northeast U.S. and earthquakes in areas of the U.S. not correlated to ICAT's underwriting focus. Some of these policies also cover the owners' incidental liabilities and account for the rest of the Syndicate's total business. ICAT controls and monitors this business on behalf of the Syndicate.

The Syndicate's insurance capacity is £80.0 million (\$121.6 million at 31 December 2014 and \$125.6 million at 31 December 2013). Insurance capacity is a measure of the maximum gross premiums, net of acquisition costs that the Syndicate is eligible to write; the Syndicate wrote \$97.5 million (\$90.8 million in 2013) in such premiums.

Key Financial Performance Indicators

In the opinion of the directors, the key financial performance indicators below best represent the performance and position of the Syndicate.

	2014 \$000	2013 \$000
Gross written premiums:		
Eastern Seaboard	24,659	15,899
Florida	44,984	46,876
Gulf Coast	28,502	30,857
Hawaii (includes direct and inward reinsurance premiums)	6,310	6,289
Earthquake (includes direct and inward reinsurance premiums)	30,718	25,241
Total gross written premiums	<u>135,173</u>	<u>125,162</u>
% of insurance capacity	80.2%	72.3%
Outward reinsurance premiums	<u>(42,731)</u>	<u>(39,848)</u>
Profit for the financial year	<u>32,549</u>	<u>24,634</u>
Members' balances	<u>44,482</u>	<u>27,281</u>
Net loss ratio	12.1%	16.6%
Combined ratio (financial basis)	64.4%	70.2%

The Syndicate's profitability improved by 32.1% compared to the last year for two reasons: minimal losses and more premiums. The Syndicate's gross written premium grew by 8.0% in 2014. The growth came from two regions, the Eastern Seaboard and the Earthquake region. The Syndicate's new partnerships provided a majority of the increase on the Eastern Seaboard and

Annual Report of the Directors of the Managing Agent (Continued)

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contributed to the increase in the Earthquake region. The Syndicate achieved this growth despite the prevalence of flat or reduced rates in the market during the year.

Though the 2014 Pacific hurricane season was the most active season on record since 1992, the Syndicate did not suffer significant catastrophe losses. The 2014 Atlantic hurricane season by comparison was a below-average season, producing the fewest storms since the 1997 season with only one making U.S. landfall. Tropical Storm Iselle was the strongest tropical cyclone on record to strike the Big Island of Hawaii and Hurricane Arthur also hit North Carolina, but the Syndicate did not incur significant losses from these storms because it did not have a high concentration of exposure in these areas. Also, the absence of the large fire and AOP losses that the Syndicate suffered in the first quarter of 2013 improved the profitability of the Syndicate in 2014. The Syndicate's net incurred claims from prior accident years developed favourably by \$0.5 million during the year.

Reinsurance costs increased because of an expanded placement of catastrophe coverage and more AOP reinsurance in 2014. The Syndicate added two new AOP reinsurance programs: Homeowners and General Liability and added a new per occurrence program as part of its Core Excess Per Risk contract which offers \$3.0 million of coverage excess of \$1.0 million in retention for losses associated with non-named windstorms. The Syndicate's growth in AOP ceded premium correlates with a growth in gross written premiums in order to retain net loss exposure within the Syndicate's risk appetite.

Despite the significant increase in purchased catastrophe coverage (\$300.0 million limit from \$240.0 million), catastrophe ceded premiums increased by only \$1.0 million from \$36.4 million in 2013 to \$37.4 million in 2014. The Syndicate achieved substantial rate reduction as a result of the soft reinsurance market and increased protection from non-traditional reinsurers.

The absence of significant catastrophe and large AOP losses combined with the growth in written premiums resulted in a profit of \$32.5 million (\$24.6 million).

Non-financial Key Performance Indicators

	2014	2013
Adherence to underwriting authority limits	100.0%	100.0%
Customer retention ratio	86.4%	81.3%

The Managing Agent contracts with ICAT to perform a majority of the Syndicate's activities. The Managing Agent's staff, however, reviews and monitors the activities of ICAT and provides actuarial (both reserving and capital modelling), regulatory compliance, and risk management services to the Syndicate. The Managing Agent is responsible for the environmental activities of the Syndicate, although by their nature, insurers generally do not produce significant environmental emissions. Therefore, the directors do not consider it appropriate to monitor and report any performance indicators for environmental matters.

Outward Reinsurance Arrangements

Catastrophe Coverage – The Syndicate has catastrophe reinsurance to protect against the adverse accumulation of losses from multiple policies as a result of large catastrophic events, each with losses in excess of \$30.0 million up to \$300.0 million (\$450.0 million in the aggregate). The Syndicate also has additional inuring reinsurance protection for Louisiana policies (the

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Louisiana Carve-out) covering catastrophic events, each with losses in excess of \$5.0 million up to \$50.0 million for each event and in the aggregate.

The Syndicate has aggregate catastrophe reinsurance to protect against an accumulation of losses in excess of \$50.0 million from multiple catastrophic events, with losses up to \$30.0 million from each event contributing to the retention, subject to a \$1.5 million deductible for each event. Combined reinsurance recoveries under this coverage and a portion of the larger catastrophic event coverage (collectively, the Shared Limit Coverage) are limited to \$60.0 million.

If the Syndicate exhausts any of its catastrophe reinsurance as a result of one catastrophic event, a portion of the coverage is automatically reinstated for additional premiums to protect against more catastrophic events during the rest of the coverage term, subject to certain aggregate limits.

Before 1 April, 2014, the Syndicate had layered catastrophe reinsurance to protect against large catastrophic events, each with losses in excess of \$30.0 million up to \$240.0 million (\$403.0 million in the aggregate), with a majority of the coverage subject to automatic reinstatement.

The reinsurers base their catastrophe reinsurance coverage pricing on the actual amount of gross catastrophe insurance business written by the Syndicate (with the exception of the flat premiums for the Shared Limit Coverage).

Attritional Catastrophe Coverage – Beginning 1 January, 2014, the Syndicate has attritional catastrophe reinsurance to protect against tornadoes, hail, and other windstorm risks, each with losses in excess of \$1.0 million up to \$4.0 million with no reinstatement.

All Other Peril Coverage – The Syndicate has reinsurance to protect against the occurrence of other events such as large fires. The Syndicate reinsures losses excluding flood, earthquake, windstorm or hail in excess of \$1.0 million (\$250,000 for residential property beginning 1 January, 2014) each building up to \$15.0 million. For multiple sinkhole collapse and terrorism events, total coverage is limited to \$27.0 million.

The Syndicate also purchases facultative reinsurance for larger risks.

General Liability Coverage – Beginning 1 January, 2014, the Syndicate cedes 80% of its general liability related written premiums (up to \$3.0 million a year) and corresponding liabilities (up to 400% of premiums ceded) to certain reinsurers under a proportional reinsurance arrangement. This coverage provides for a sliding scale ceding commission of 20% to 30% of the outward reinsurance premiums based on the resulting loss ratio of the reinsured business.

Future Outlook

The Syndicate increased its insurance capacity for the 2015 Underwriting Year to £90.0 million (\$153.9 million) in anticipation of continued growth. Despite expected premium rate reductions, the Syndicate plans to grow its PBU business, primarily in the Florida and Earthquake regions, in peak demand zones previously constrained by exposure limitations. The Syndicate will continue to grow assumed reinsurance business in California. The Syndicate together with ICAT will remain active in seeking partnerships with other potential coverholders and ceding insurers to help drive further growth.

Investments

The Syndicate's investment strategy seeks to preserve capital and maintain enough liquidity to support the underwriting activities of the business. The Managing Agent delegates the management of funds under its control in the U.S. situs trust funds and the Lloyd's Dollar Trust

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Fund to an external fund manager, General Re – New England Asset Management (GR-NEAM). The Managing Agent, in consultation with ICAT, established investment guidelines for the fund manager to follow. Under these guidelines, the fund manager maintains an investment portfolio, which focuses on credit quality in the selection of investments and avoids complex instruments and investments correlated to the Syndicate's loss exposures in areas prone to hurricanes and tropical storms.

The directors evaluate the fund manager's performance against the Bank of America Merrill Lynch 0-1 year U.S. Treasury Notes and Bonds benchmark. The fund manager slightly outperformed this benchmark by 0.02% during the year. U.S. trust funds include the U.S. situs trust funds and the Lloyd's Dollar Trust Fund (the Syndicate's main operating account) under the Managing Agent's control. U.S. trust funds also include the Lloyd's Joint Asset Trust Funds (JATF), which provide additional support to the U.S. situs funds. Citibank is the custodian of the U.S. situs trust funds and Lloyd's Dollar Trust Fund, while The Bank of New York Mellon Corporation is the custodian of the JATF. The U.S. situs trust funds and JATF protect the Syndicate's policyholders as required by U.S. regulators and are unavailable for use in the Syndicate's operations.

Foreign Exchange

Foreign exchange is not significant to the Syndicate, since the Syndicate transacts all of its business in the U.S. in U.S. Dollars.

Principal Risks and Uncertainties

The following paragraphs summarise the principal risks and uncertainties facing the Syndicate.

Insurance Risk

Underwriting Risk – Underwriting risk may either arise from an inaccurate assessment of the risks entailed in writing an insurance policy or from factors wholly out of the Syndicate's control. As a result, losses paid by the Syndicate may exceed earned premiums. The Syndicate tries to reduce underwriting risk by basing its risk appetite on its maximum loss tolerance. The Syndicate sets its tolerance for catastrophe losses based on nationwide and regional Exceedance Probabilities (EP) in the U.S., as well as on Realistic Disaster Scenarios (RDS) designed to stress test the Syndicate for material catastrophe risks at different probability levels by potential loss of capital. The EP is the probability that losses exceed a certain threshold for a catastrophic loss event at a selected probability of occurrence. The Syndicate generally quantifies its risk appetite at the 99.5% EP level or the 1 in 200 year return time. RDS include the events below.

- i. Two separate Eastern Seaboard windstorms
- ii. Two separate Florida windstorms
- iii. Gulf windstorm
- iv. Two separate California earthquakes
- v. New Madrid earthquake
- vi. Two separate Syndicate-specific scenarios

The Syndicate 1 in 200 year nationwide EP estimated losses increased from \$265.1 million at 31 December 2013 to \$373.1 million by the peak of the 2014 hurricane season due to the growth in the Syndicate. The Syndicate monitors EP estimated losses and balances the offering of new and renewal accounts between low and high loss-driving areas. The Syndicate sets its tolerance for

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AOP losses at the building and location level. ICAT monitors the Syndicate's loss exposures against its underwriting risk appetite using various methods, including RDS modelling. Also, the Syndicate periodically evaluates and adjusts its reinsurance protection to manage its overall retention of insurance risk.

Under the binding authority agreement with the Syndicate, ICAT underwrites most of the Syndicate's business. ICAT sets and controls the underwriting authority of each of its underwriters within two groups: the Product Management group, responsible for PBU underwriting, and the Individual Risk Underwriting group, responsible for MMBU underwriting. Underwriters adhere to daily monitored regional blueprints, which identify where the Syndicate's insurance capacity should be deployed. These blueprints, with their defined underwriting guidelines alongside modelling and pricing practices, determine the prescribed range of rates at which ICAT may sell the Syndicate's insurance capacity. Underwriters must refer underwriting decisions for risks outside of those outlined in the blueprints or in excess of their authority limit to higher levels of authority. ICAT audits the individuals who have binding authority in both groups on a regular basis to ensure adherence to established underwriting authority limits. ICAT also conducts other underwriting audits on an ad-hoc basis and reviews the significant business written each month. The Managing Agent also has its own controls.

The Managing Agent has a governance structure in place to monitor the underwriting and loss exposure management controls of ICAT. The Managing Agent appoints the Syndicate Board (the Board), which manages the Syndicate. The Board ensures the appropriate management of the Syndicate in accordance with the Managing Agent's responsibilities. The Board meets quarterly and has delegated authority to approve underwriting related matters, including:

- i. non-material changes to the business plan,
- ii. underwriting authority levels and guidelines,
- iii. operational and coverholder procedures,
- iv. risk policies, the risk register, and all other risk management matters, and
- v. the Syndicate's compliance plan.

The Managing Agent also monitors the Syndicate's performance against its underwriting risk appetite in several ways, including regular meetings with the Active Underwriter and participation in the monthly meetings of the Production Risk Management Committee (the Committee), which is a subcommittee of the Board, that considers reports from the Active Underwriter and other areas of the business. The Committee also reviews underwriting related matters, including:

- i. progress against the business plan or forecast,
- ii. premium rates and volumes,
- iii. overall loss exposures,
- iv. significant product and premium rate changes;
- v. market conditions, and
- vi. the outcome of underwriting audits covering the operations of ICAT.

Furthermore, Paraline International provides oversight of the underwriting policies adopted by the Active Underwriter. Paraline International identifies key underwriting guidelines and limitations in

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the binding authority agreement between ICAT and the Syndicate and monitors ICAT adherence to these underwriting guidelines including consideration of material changes in underwriting authority, risk profile, reinsurance, and any breaches of the ICAT binding authority agreement.

The Syndicate's annual business planning process sets the targets for written premiums and overall profitability for the coming year. Factors taken into account in determining these targets include the risk appetite of the Syndicate's capital providers, anticipated pricing, insurance policy terms and conditions, and other risk metrics.

Reserving Risk – The Syndicate's financial condition and profitability depend heavily on its ability to accurately assess its liability for claims outstanding from its insured and reinsured risks. The Syndicate tries to reduce the risk associated with this assessment by hiring qualified third party claims administrators that have specialised adjusters and forensic engineers to set reserves on notified damaged properties and incidental liability claims. Both ICAT and the Managing Agent review these reported claims monthly. The Syndicate also employs standard actuarial methods to assess its overall best estimate of reserves for each underwriting account quarterly using historical losses loaded for future uncertainty in areas where reserves may prove to be materially inadequate; this assessment process requires ongoing discussions between the Syndicate's actuaries and the underwriters and claims adjusters of ICAT, and includes various levels of approval supplemented by external actuarial validation. The Syndicate's actuaries track projected loss ratios quarterly and may reassess their reserving methods if necessary. The Board approves the reserves of the Syndicate quarterly, after considering the recommendation of the Reserve Committee (a subcommittee of the Board).

Catastrophe Risk – The occurrence of adverse economic conditions, natural or other disasters, or other circumstances specific to or otherwise significantly impacting the regions and states in which the Syndicate mainly underwrites in may adversely affect its profitability and financial condition. The Syndicate tries to limit this risk through geographic diversification. ICAT uses catastrophe models to set the Syndicate's overall loss exposure limits; these models include provisions for secondary uncertainty, loss amplification (demand surge), and storm surge. ICAT models every property in the Syndicate's book of business semi-monthly and then adjusts the results to address perceived deficiencies in these models to better reflect historical losses. In managing the Syndicate's risk appetite, ICAT allocates limits to various geographic zones. The identification and determination of each zone and its area as well as whether to include a particular policy within a zone's limits requires significant judgment. ICAT controls and limits the Syndicate's concentration of risk within these zones as well as the risk at the neighbourhood and street level using an accumulation tool.

In addition to the Syndicate's catastrophe risks, the Syndicate's profitability and financial condition may be adversely affected by unexpectedly large accumulations of AOP losses and incidental liability claims. ICAT tries to reduce this risk to the Syndicate by using appropriate underwriting processes to guide the pricing and acceptance of risks. These processes help to ensure that premiums cover the expected levels of loss.

The Syndicate tries to limit its risk of insolvency from a single large catastrophe or multiple smaller catastrophes by purchasing reinsurance. The probability of catastrophes is evaluated using a catastrophe model that quantifies its hurricane and earthquake related loss exposures. The catastrophe model used by the Syndicate is developed by applying ICAT's model adjustment methodology on a model from a major vendor to align the vendor model to the Syndicate's view of risk. The Syndicate applies ICAT's model adjustment methodology because it estimates building vulnerability, coverage leakage, losses from inland risks and coastal risks, and landfall frequency and severity more precisely than the vendor model. The Syndicate validates the results from this methodology against alternate models from other major vendors.

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Reinsurance Risk – The cost of reinsurance also impacts the Syndicate where the availability of reinsurance and associated pricing is subject to prevailing market conditions which fluctuate in cycles over time. These cycles are affected by various factors including the frequency and severity of worldwide catastrophic events, market capacity, competition, and general economic conditions. The Syndicate monitors market cycles and seeks favourable reinsurance pricing with secure reinsurers.

Operational Risk

Operational risk is the risk that events caused by people, internal controls, processes, or systems lead to losses for the Syndicate. The Managing Agent together with ICAT and Paraline International try to manage this risk for the Syndicate by having detailed procedure manuals in place alongside a structured assurance program for the ongoing testing of processes and systems. They also have business continuity and disaster recovery plans in place that they regularly update and test. The close involvement of the directors in the Syndicate's key decision making further reduces the risk of these losses.

Market Risk

Interest Rate Risk – Increasing market interest rates reduce the value of the Syndicate's fixed maturities. The Syndicate may realise a loss if it sells fixed maturities whose value has fallen below their acquisition cost. Declining market interest rates may reduce the Syndicate's investment income, as it invests proceeds from positive operating cash flows and reinvests proceeds from maturing or called investments in new investments that may yield less than the investment portfolio's historical average rate of return. Interest rates are highly sensitive to many factors, including government monetary policies, domestic and international economic and political conditions, and other factors beyond the Syndicate's control. The Syndicate tries to reduce this risk by maintaining an average duration of one year or less in its investment portfolio to provide downside protection against increases in interest rates.

Currency Risk – The Syndicate writes all its business in U.S. Dollars, which is its functional currency. The Syndicate also keeps all of its reinsurance balances and investments in U.S. Dollars. The Syndicate has Sterling expenses; these expenses do not create material currency risk for the Syndicate. The Syndicate has no exposure to other currencies.

Investment Price Risk – Disruptions in the public debt market, including widening credit spreads, bankruptcies, and government intervention in large financial institutions, may result in significant realised and unrealised losses in the Syndicate's investment portfolio. Also, market conditions and other factors beyond the Syndicate's control could cause the credit quality ratings of its investments to deteriorate. If the Syndicate liquidates these securities during a period of tightening credit in the financial markets, it may realise a significant loss. The Syndicate tries to limit this risk by generally holding its investments to maturity.

Credit Risk

Bankruptcy, liquidity problems, distressed financial condition, or the general effects of the current economic environment may increase the risk that policyholders or intermediaries, such as insurance agents and brokers, may not pay a part of or the full amount of premiums owed to the Syndicate's coverholders, despite an obligation to do so. If non-payment becomes widespread, whether as a result of bankruptcy, lack of liquidity, adverse economic conditions, operational failure, or otherwise, it could have a material adverse impact on the financial condition of the Syndicate's coverholders and their ability to pay the premiums they in turn owe to the Syndicate. No single agent, broker, or policyholder accounted for more than 11.0% (10.2% in 2013) of the

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premiums that the coverholders wrote for the Syndicate and 10.5% of premium balances due at 31 December 2014 (12.3% at 31 December 2013). Further, insurance policies may be cancelled for non-payment from policyholders.

The Syndicate transfers significant amounts of insurance risk to reinsurers. If these reinsurers fail to honor their obligations, the Syndicate's financial condition, profitability, and cash flows could be adversely affected. The Syndicate tries to reduce this risk by setting maximum exposure and credit limits for each of its reinsurers based on their industry credit rating and net asset balance. The Syndicate regularly evaluates the financial condition and payment performance of its reinsurers with the help of outside brokers; evaluations include reviewing credit ratings and monitoring concentrations of credit risk arising from similar geographic regions, activities, or economic characteristics to minimise the Syndicate's exposure to significant losses from reinsurer insolvencies. The Syndicate mostly purchases reinsurance from reinsurers with an A.M. Best or Standard & Poor's rating of A or better. If a reinsurer does not have an A or better rating, the Syndicate may obtain collateral from the reinsurer to secure their reinsurance obligations. The Syndicate had collateral of \$92.6 million from certain reinsurers at 31 December 2014 to secure their obligations. No single reinsurer accounted for more than 23.5% of reinsurance balances recoverable at 31 December 2014 (21.2% at 31 December 2013). There were no catastrophe reinsurance recoveries and only a small amount of AOP recoveries outstanding at 31 December 2014.

Liquidity Risk

The Syndicate's operations could be adversely affected if it did not have cash to pay insurance claims and other liabilities. The Syndicate tries to reduce this risk by reviewing its expected cash obligations on a quarterly basis and keeping adequate cash on deposit to meet those obligations. The Syndicate settles its payment obligations in accordance with the vendor terms of each transaction. At 31 December 2014 billings were 20 days outstanding (15 days at 31 December 2013). The Syndicate holds any excess funds in cash or invests them in money funds readily convertible to cash without excessive cost to the business. The Syndicate also has a \$35.0 million letter of credit facility from Barclays that it collateralised with reinsurance balances recoverable and premiums receivable.

Regulatory and Compliance Risk

The Syndicate is subject to continuing approval by Lloyd's to operate in the Lloyd's market and must comply with the regulatory requirements set by Lloyd's, the Financial Conduct Authority (FCA) and Prudential Regulatory Authority (PRA). Lloyd's requirements include those imposed on the Lloyd's market by overseas regulators, particularly by U.S. regulators concerning U.S. risks underwritten by the Lloyd's market. The Syndicate tries to reduce the risk of its approval to operate in the Lloyd's market from being revoked by monitoring and fully complying with all of its regulatory obligations. The Managing Agent helps the Syndicate in this regard by regularly monitoring regulatory and legal compliance related developments and assessing the impact of these developments on agency and Syndicate policies.

Insurance business is state regulated in the U.S., and therefore, state legislatures may enact laws that adversely affect the industry. Such unfavourable changes could adversely impact the Syndicate's operations. The Syndicate's operating status in all states as an approved non-admitted surplus lines carrier rather than as a licensed and admitted carrier, however, reduces this risk. Surplus lines carriers are less regulated, specifically in the forms they use and the rates they can charge. Surplus lines carriers, however, cannot write insurance that is typically available in the admitted market and, traditionally, may only write a policy if it has been rejected by three different admitted carriers and provided the agent or broker placing the business with them has a surplus

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lines license. Surplus lines carriers are not protected by state guarantee funds, although the U.S. trust funds and Lloyd's Central Fund provide a chain of security for the Syndicate's policyholders.

Future Developments

In accordance with business planning, the Syndicate increased its allowable capacity to write business from £80.0 to £90.0 million for the 2015 underwriting year. The Syndicate will continue to pursue opportunities to grow the portfolio while remaining within risk tolerance. The limits on earthquake policies and the tolerance of RDS and EP gross loss estimates will increase commensurate with the targeted growth of business.

Payments to Members

The Syndicate generally releases a majority of the profits on each of its open underwriting years to members at the end of two calendar years. Therefore, the directors propose a \$26.3 million open year profit release to the members of the 2013 underwriting year.

Directors

The people below were directors of the Managing Agent of the Syndicate from 1 January 2014 to the date of this report.

T A Riddell, Chairman and Non-Executive Director	
Y A Bouman	Appointed 4 July 2014
G M J Erulin, Non-Executive Director	
L Harfitt	
A J Hubbard, Non-Executive Director	Appointed 1 April 2014
D J G Hunt	
D F C Murphy, Non-Executive Director	
S P A Norton	
J W Ramage, Non-Executive Director	
J M Tighe	
H M Westcott	Resigned 30 April 2014

The directors of Asta did not participate on the Syndicate and did not have an interest in any of its contracts.

Annual Report of the Directors of the Managing Agent (Continued)

31 December 2014

Disclosure of Information to Auditors

Each of the directors who held office at the approval date of this report confirms to the best of their knowledge, that there is no relevant audit information of which the Syndicate's auditors are unaware, and each Director took all action necessary as a Director to become aware of any relevant audit information and to establish that the Syndicate's auditors are aware of that information.

Auditors

Pursuant to Section 14(2) of Schedule 1 of the Insurance Accounts Directive (Lloyd's Syndicate and Aggregate Accounts) Regulations 2008, the auditors will be deemed to be reappointed and KPMG LLP will therefore continue in office.

On behalf of the Board



Charmaine Chow
Company Secretary
13 March 2015

Statement of Managing Agent's Responsibilities

31 December 2014

The Managing Agent must prepare the directors' annual report and accounts for Syndicate 4242 (the Syndicate) in accordance with applicable law and regulations.

The Insurance Accounts Directive (Lloyd's Syndicate and Aggregate Accounts) Regulations 2008 require the Managing Agent to prepare accounts for the Syndicate at 31 December each year in accordance with applicable law and United Kingdom (U.K.) accounting standards (U.K. Generally Accepted Accounting Practice). Law requires that the accounts give a true and fair view of the state of affairs of the Syndicate at that date and its profit or loss for the year.

In preparing the Syndicate's accounts, the Managing Agent must:

- i. select suitable accounting policies and apply them consistently, subject to changes from new accounting standards adopted during the year;
- ii. make reasonable and prudent judgments and accounting estimates;
- iii. state whether they followed applicable accounting standards, subject to any material departures disclosed and explained in the notes to the accounts; and
- iv. prepare the accounts on the basis that the Syndicate will continue to write business for the foreseeable future unless it is inappropriate to presume so.

The Managing Agent must keep adequate accounting records that disclose with reasonable accuracy at any time the financial condition of the Syndicate and enable the Managing Agent to ensure that the Syndicate's annual accounts comply with the 2008 regulations. The Managing Agent must also safeguard the assets of the Syndicate by taking reasonable steps to prevent and detect fraud and other irregularities.

The Managing Agent is responsible for the maintenance and integrity of the corporate and financial information included on its website. Legislation in the U.K. governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Independent Auditors' Report to the Members of Syndicate 4242

We have audited the Syndicate 4242 annual accounts for the year ended 31 December 2014, as set out on pages 19 to 40. The financial framework that has been applied in their preparation is applicable law and UK accounting standards (UK Generally Accepted Accounting Practice).

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

Respective responsibilities of the Managing Agent and auditors

As explained more fully in the Statement of Managing Agent's Responsibilities set out on page 16, the Managing Agent is responsible for the preparation of syndicate annual accounts which give a true and fair view. Our responsibility is to audit, and express an opinion on, the syndicate annual accounts in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of syndicate annual accounts

A description of the scope of an audit of accounts is provided on the Financial Reporting Council's website at www.frc.org.uk/auditscopeukprivate.

Opinion on syndicate annual accounts

In our opinion the annual accounts:

- give a true and fair view of the syndicate's affairs at 31 December 2014 and its profit for the year then ended;
- have been properly prepared in accordance with UK Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Insurance Accounts Directive (Lloyd's Syndicate and Aggregate Accounts) Regulations 2008.

Opinion on other matters prescribed by the Insurance Accounts Directive (Lloyd's Syndicate and Aggregate Accounts) Regulations 2008

In our opinion the information given in the Annual Report of the Directors of the Managing Agent for the financial year in which the annual accounts are prepared is consistent with the annual accounts.

Independent Auditors' Report to the Members of Syndicate 4242 (Continued)

Matters on which we are required to report by exception

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

- the Managing Agent in respect of the syndicate has not kept adequate accounting records; or
- the syndicate annual accounts are not in agreement with the accounting records; or
- we have not received all the information and explanations we require for our audit.



Salim Tharani (Senior Statutory Auditor)
for and on behalf of KPMG LLP, Statutory Auditor
Chartered Accountants
London

13 March 2015
15 Canada Square
London
E14 5GL

Profit and Loss Account - Technical Account
Year Ended 31 December 2014

	Note	2014 \$000	2013 \$000
Technical account - General business:			
Earned premiums, net of reinsurance:			
Gross premiums written	3	135,173	125,162
Outward reinsurance premiums		<u>(42,731)</u>	<u>(39,848)</u>
Net premiums written		92,442	85,314
Change in the gross provision for unearned premiums	13	(2,532)	(2,501)
Change in the provision for unearned premiums, reinsurers' share	13	<u>1,371</u>	<u>(406)</u>
Net change in provision for unearned premiums		(1,161)	(2,907)
Earned premiums, net of reinsurance		91,281	82,407
Allocated investment return transferred from the non-technical account	5	18	27
Claims incurred, net of reinsurance:			
Claims paid:			
Gross amount		(11,588)	(20,454)
Reinsurers' share		<u>75</u>	<u>1,580</u>
Claims paid		(11,513)	(18,874)
Change in the provision for claims:			
Gross amount	13	446	6,558
Reinsurers' share		<u>37</u>	<u>(1,332)</u>
Change in provision for claims		483	5,226
Claims incurred, net of reinsurance		(11,030)	(13,648)
Net operating expenses	6, 7	<u>(47,720)</u>	<u>(44,152)</u>
Balance on technical account - general business		<u>32,549</u>	<u>24,634</u>

All operations relate to continuing activities.

The notes on pages 24 to 40 form part of these annual accounts.

Profit and Loss Account - Non-technical Account
Year Ended 31 December 2014

	Note	2014 \$000	2013 \$000
Balance on the technical account - general business		32,549	24,634
Investment income	5	98	86
Unrealised gains on investments	5	5	6
Investment expenses and charges	5	(77)	(56)
Unrealised losses on investments	5	(8)	(9)
Allocated investment return transferred to general business technical account	5	(18)	(27)
Profit for the financial year		<u>32,549</u>	<u>24,634</u>

All operations relate to continuing activities.

Syndicate 4242 had no recognised gains and losses this year or last year other than those included in the Profit and Loss Account. Therefore, the directors of the Managing Agent have not presented a separate Statement of Total Recognised Gains and Losses.

The notes on pages 24 to 40 form part of these annual accounts.

Balance Sheet
At 31 December 2014

	Note	2014 \$000	2013 \$000
Assets:			
Investments:			
Other financial investments	8	73,968	62,723
Reinsurers' share of technical provisions:			
Provision for unearned premiums	13	4,861	3,490
Claims outstanding		205	168
		<u>5,066</u>	<u>3,658</u>
Debtors:			
Debtors arising out of direct insurance operations	9	13,238	15,123
Debtors arising out of reinsurance operations		1,835	1,446
Other debtors		541	275
		<u>15,614</u>	<u>16,844</u>
Other assets:			
Cash at bank and in hand		11,467	1,021
Overseas deposits	10	474	440
		<u>11,941</u>	<u>1,461</u>
Prepayments and accrued income:			
Accrued interest		4	19
Deferred acquisition costs		14,108	13,164
Other prepayments and accrued income		2,070	2,026
		<u>16,182</u>	<u>15,209</u>
Total assets		<u><u>122,771</u></u>	<u><u>99,895</u></u>

The notes on pages 24 to 40 form part of these annual accounts.

Balance Sheet
At 31 December 2014

	Note	2014 \$000	2013 \$000
Liabilities:			
Capital and reserves:			
Members' balances	11	44,482	27,281
Technical provisions:			
Provision for unearned premiums:			
Gross amount	13	50,599	48,067
Claims outstanding:			
Gross amount		9,132	9,578
		59,731	57,645
Creditors:			
Creditors arising out of direct insurance operations		108	17
Creditors arising out of reinsurance operations		9,338	8,511
Other creditors	14	862	726
		10,308	9,254
Accruals and deferred income		8,250	5,715
Total liabilities		<u>122,771</u>	<u>99,895</u>

The board of Asta Managing Agency Ltd approved Syndicate 4242's annual accounts on pages 19 to 40 on 9 March 2015, which the Director below signed on the board's behalf.



David J G Hunt
Director
13 March 2015

The notes on pages 24 to 40 form part of these annual accounts.

Cash Flow Statement
Year Ended 31 December 2014

	Note	2014 \$000	2013 \$000
Net cash inflow from operating activities	15	37,052	22,654
Payments of profit to members	11, 12	(15,202)	(11,639)
Other		(146)	(159)
		<u>21,704</u>	<u>10,856</u>
Cash flows were invested as follows:			
Increase / (Decrease) in cash holdings	17	10,446	(473)
Increase in overseas deposits	17	34	69
Net portfolio investment	16, 17	11,224	11,260
Net investment of cash flows		<u>21,704</u>	<u>10,856</u>

The notes on pages 24 to 40 form part of these annual accounts.

Notes to the Annual Accounts

31 December 2014

(1) Basis of Preparation

The directors of the Managing Agent (the directors) prepared these annual accounts for Syndicate 4242 (the Syndicate) in accordance with the Insurance Accounts Directive (Lloyd's Syndicate and Aggregate Accounts) Regulations 2008 and accounting standards in the United Kingdom (U.K.) applicable to the Syndicate as if it were an insurance company formed and registered under the Companies Act 2006. These accounts comply with the Statement of Recommended Practice on Accounting for Insurance Business issued by the Association of British Insurers in December 2005 and amended in December 2006.

(2) Accounting Policies

The directors consistently applied the material accounting policies below in preparing these annual accounts.

(a) *Gross Premiums Written*

Gross premiums written consist of premiums on insurance contracts bound during the year. Gross premiums written also include premiums on reported but unprocessed insurance contracts at the balance sheet date, inward reinsurance premiums from ceding insurance companies, including portfolio transfers, and a deduction for expected insurance contract cancellations. The Syndicate shows premiums gross of coverholder commissions and excludes taxes and fees levied on them.

(b) *Outward Reinsurance Premiums*

Outward reinsurance premiums consist of premiums on outward reinsurance contracts bound during the year to reduce the Syndicate's exposure to losses from catastrophes, all other property perils, and incidental liability claims. Reinsurance transactions do not relieve the Syndicate of its primary obligations to its policyholders.

(c) *Provision for Unearned Premiums*

The provision for unearned premiums is the portion of gross premiums written that the Syndicate will earn in the future and the corresponding amount of reinsurance premiums that it will expense. The Syndicate earns hurricane premiums, inclusive of attritional catastrophe coverage covering tornados, hail, and other windstorm risks, evenly over the Atlantic Hurricane Season(s) (the incidence of risk) that occur during the policy term. The Atlantic Hurricane Season runs from June 15th to November 15th of each year. The Syndicate earns earthquake and all other property peril premiums evenly over the policy term. The Syndicate expenses related reinsurance premiums evenly over the contract term, or incidence of risk, if significantly different.

(d) *Provision for Unexpired Risks*

At the balance sheet date, the Syndicate makes a provision for unexpired risks where the value of claims and administrative expenses expected to arise after the balance sheet date from the insurance contracts entered into before the balance sheet date exceeds the provision for unearned premiums, the amount of premiums receivable under those contracts, after the deduction of any deferred acquisition costs.

The directors calculate the provision for unexpired risks by class of business, after considering related investment returns. No provision for unexpired risks was recorded in 2014 or 2013.

Notes to the Annual Accounts (Continued)

31 December 2014

(2) Accounting Policies (Continued)

(e) *Claims Incurred, Net of Reinsurance*

Gross claims incurred consist of the estimated cost of settling all claims occurring before the balance sheet date, whether reported or not, including related claims handling expenses. The Syndicate does not discount claims outstanding. The Syndicate anticipates subrogation recoveries when it sets provisions for reported claims. The Syndicate accounts for reinsurance recoveries when it incurs the related losses.

The directors assess the provision for claims outstanding on a case basis based on the estimated cost of all claims notified but not settled at the balance sheet date. The provision also includes the estimated cost of claims incurred but not reported (IBNR) at the balance sheet date based on statistical methods and includes adjustments for catastrophes and other significant events, changes in historical trends, economic and social conditions, judicial decisions, and legislation, as necessary. In evaluating the provision, the directors use the findings of the Syndicate's actuaries, which include an associated third party claims administrator's loss estimates for large catastrophes.

The claims administrator, together with loss modelling staff, base the selected estimate of losses for each large catastrophe after considering the range of ultimate loss estimates using various methods. Such methods include expected claim count and average cost per claim, incurred loss development, stochastic event scenario modelling from different software vendors, market share analysis, and other information, including independent third party evaluations. For smaller catastrophes and all other property perils, the Syndicate's actuaries apply Initial Expected Loss Ratios (IELRs) for each class of business, which is segmented by homogeneous regions and policy types. The Syndicate's actuaries develop these IELRs against catastrophe models, market data, and past claims on similar classes of business.

The provision for claims outstanding is subject to significant variability. While the directors believe that the recorded provision for gross claims and reinsurance recoveries is adequate, establishing this liability is a judgmental and inherently uncertain process. Therefore, it is possible that actual losses may not conform to the assumptions that the directors used in determining the amount of this provision. Accordingly, the ultimate provision may be significantly greater or less than the outstanding amount held at the balance sheet date. The Syndicate recognises adjustments to the provision for claims outstanding in the profit and loss account when known. The nature of short tail claims, such as the property insurance that the Syndicate provides, where policyholders typically notify the Syndicate of their claims within an average of 28 days and the Syndicate typically settles these claims within a short time period which is normally less uncertain after a few years than long tail risks, such as some liability lines of business, where it may be several years before policyholders advise their insurance carriers of their claims and the carriers settle them.

The directors base the reinsurers' share of the provision for claims outstanding on the provisions for reported claims and IBNR, net of estimated irrecoverable amounts from potential reinsurer insolvencies based on the type of balance and security ratings of the involved reinsurers. The directors use statistical methods to help them make these estimates.

Notes to the Annual Accounts (Continued)

31 December 2014

(2) Accounting Policies (Continued)

(f) *Claims Handling Expenses*

Claims handling expenses mostly consist of fees that the Syndicate pays to an associated third party claims administrator for the handling of claims on its behalf. In exchange for these services, the Syndicate pays a base fee equal to a percentage of gross premiums written. The paid fee gives the Syndicate access to the claims administrator's staff for the administration of claims; it also entitles the Syndicate to a predetermined number of new claim file allowances. To the extent that actual claim volume exceeds the accumulated claim file allowances under the base fee, the claims administrator charges an additional fee for each additional claim.

This claims administration arrangement contains multiple deliverables, each representing a separate unit of accounting. As such, the Syndicate defers the portion of fees attributable to new claim file allowances based on their selling prices (contract rates) until actual claims are reported against them, or the allowances expire, whichever occurs first. If an actual claim is reported against a claim file allowance, the Syndicate recognises the allowance expense over the period that the claim is administered based on historical settlement patterns. If a claim is not reported against a claim file allowance before the allowance expires, the Syndicate includes the allowance in the profit and loss account when the allowance expires. The Syndicate defers the rest of the base fee (for access to staff and infrastructure) and recognises it as expense evenly over the term of services. The Syndicate includes deferred claims handling expenses in other prepayments and accrued income.

(g) *Acquisition Costs, Net of Reinsurance*

Acquisition costs consist of coverholder and ceding commissions (on inward reinsurance acceptances) primarily related to the production of new and renewal business. The Syndicate defers acquisition costs to the extent that they are attributable to unearned premiums at the balance sheet date and expenses them as it earns the underlying insurance contract premiums. The Syndicate includes acquisition costs in net operating expenses. The Syndicate defers recoveries of acquisition costs (ceding commissions) from outward reinsurers and includes them in accruals and deferred income. The Syndicate earns ceding commissions as it expenses underlying reinsurance contract premiums and includes them in net operating expenses under reinsurance commissions and profit participation.

(h) *Investments*

Investments consist of shares and other variable yield securities and debt and fixed income securities. The Syndicate carries investments at current or market value.

Notes to the Annual Accounts (Continued)

31 December 2014

(2) Accounting Policies (Continued)

(i) *Investment Return*

Investment return consists of income from investments, gains and losses on the realisation of investments, and movements in unrealised gains and losses on investments, net of investment management expenses. Income from investments consists of interest, which the Syndicate recognises when earned. The Syndicate bases realised gains and losses on each investment on the difference between the sale proceeds and the cost of the investment. Movements in unrealised gains and losses on investments represent the difference between the carrying value of investments at the balance sheet date and the purchase price of investments in earlier accounting periods, after considering investment disposals. Investment management expenses consist of investment custodian and fund management fees.

The Syndicate first records its investment return in the non-technical account. The Syndicate then transfers this return to the general business technical account to reflect the investment return on funds supporting the Syndicate's underwriting business.

(j) *Net Operating Expenses*

The Syndicate recognises operating expenses when incurred. Operating expenses include acquisition costs and the change in deferred acquisition costs, administrative expenses, and reinsurance commissions and profit participation. Administrative expenses consist of:

- i. operating costs,
- ii. Managing Agent fees,
- iii. Lloyd's membership costs, and
- iv. auditor fees.

Administrative expenses also include profit commissions charged by the Managing Agent. Profit commissions equal a percentage of each underwriting year's profits subject to a two-calendar-year deficit carry-forward provision. The Syndicate charges commissions to expense when incurred. The Syndicate recognises brokerage sharing when brokers place the reinsurance coverage.

Reinsurance commissions and profit participation consist of ceding and contingent profit commissions from reinsurers. The Syndicate recognises ceding commissions as it expenses the underlying reinsurance premiums and accrues for contingent profit commissions based on the contract formulas. The Syndicate's contingent profit commission calculations include a provision for IBNR.

Notes to the Annual Accounts (Continued)

31 December 2014

(2) Accounting Policies (Continued)

(k) *Taxation*

Schedule 19 of the Finance Act 1993 does not require the Managing Agent to deduct basic rate income tax from the Syndicate's trading income. Also, the Managing Agent may recover all U.K. basic rate income tax (now at 20%) deducted from the Syndicate's investment income. Therefore, payments of profits made to members of the Syndicate or their members' agents are gross of tax. Trading income includes capital appreciation, which is also paid gross of tax. The Syndicate did not make any provision for U.S. federal income tax payable on its underwriting results or investment earnings. The Syndicate's members pay these taxes alongside the U.K. income taxes resulting from the Syndicate's trading and investment income. The Syndicate includes any tax payments made on account of its members during the year in members' balances.

(l) *Foreign Currency Translation*

The Syndicate's functional and reporting currency is the U.S. Dollar. The directors measure foreign currency assets and liabilities at the closing exchange rate in effect at the balance sheet date, while they measure foreign currency revenues and expenses at the historical exchange rates in effect at the time of the related transactions. The directors used an exchange rate of 1.55 to translate Sterling balances into U.S. Dollars at 31 December 2014 (1.66 at 31 December 2013).

(m) *Contingent Liabilities*

The Syndicate records liabilities for loss contingencies arising from claims, assessments, litigation, fines, penalties, and other sources when it is probable that it incurred such a liability, and that liability is reasonably estimable. The Syndicate expenses legal costs in connection with loss contingencies when incurred and includes them in net operating expenses.

Notes to the Annual Accounts (Continued)

31 December 2014

(3) Segment Reporting

The tables below detail the Syndicate's underwriting results before investment return by class of business.

	2014 \$000					
	Gross premiums written	Gross premiums earned	Gross claims incurred	Gross operating expenses	Reinsurance Balance	Total
Fire and other damage to property	125,575	125,415	(10,898)	(45,186)	(37,497)	31,834
Third party liability	311	156	(25)	(18)	(104)	9
Reinsurance accepted	9,287	7,070	(219)	(3,509)	(2,654)	688
Total	135,173	132,641	(11,142)	(48,713)	(40,255)	32,531

	2013 \$000					
	Gross premiums written	Gross premiums earned	Gross claims incurred	Gross operating expenses	Reinsurance Balance	Total
Fire and other damage to property	119,206	116,661	(13,895)	(41,577)	(38,712)	22,477
Reinsurance accepted	5,956	6,000	—	(3,152)	(718)	2,130
Total	125,162	122,661	(13,895)	(44,729)	(39,430)	24,607

Included in the reinsurance balance are reinsurance commissions and profit participation of \$993,249 (\$576,665 in 2013).

Surplus lines wholesale brokers pay fire and other damage to property premiums to the Syndicate's coverholders in single payments, while policyholders working through licensed retail agents pay premiums in single or multiple instalments to ceding insurance companies.

The Syndicate only writes business in the U.S.

Commissions paid or payable on direct insurance business totalled \$34.2 million (\$32.1 million in 2013).

Notes to the Annual Accounts (Continued)

31 December 2014

(4) Claims Movement

The Syndicate's net incurred claims from prior accident years developed favourably by \$0.5 million during year (\$3.2 million in 2013). This positive development of run-off losses during the year reflects loss reserve reductions on various claims. There were no significant movements in the reserves for past catastrophes.

(5) Investment Return

	2014 \$000	2013 \$000
Income from investments	88	83
Gains on realisation of investments	10	3
Unrealised gains on investments	5	6
Losses on realisation of investments	—	(1)
Unrealised losses on investments	(8)	(9)
Investment management expenses	(77)	(55)
Total	<u>18</u>	<u>27</u>

This table details the average funds available for investment, investment returns, and investment yields. The Syndicate holds all of its investments in U.S. Dollars.

	2014 \$000	2013 \$000
Average funds available for investment	73,567	57,110
Investment returns	88	83
Investment yield	0.1%	0.1%

(6) Net Operating Expenses

	2014 \$000	2013 \$000
Acquisition costs	37,618	34,334
Change in deferred acquisition costs	(944)	(671)
Administrative expenses	12,039	11,066
Reinsurance commissions and profit participations	(993)	(577)
Total	<u>47,720</u>	<u>44,152</u>

Notes to the Annual Accounts (Continued)

31 December 2014

(6) Net Operating Expenses (Continued)

This table details administrative expenses included in net operating expenses.

	2014 \$000	2013 \$000
Operating costs (includes Managing Agent recharges)	2,767	2,643
Managing Agent fees and profit commissions	9,147	8,307
Lloyd's membership costs	766	892
Auditor remuneration - audit fees	296	305
Auditor remuneration - non audit fees	66	62
Brokerage sharing	(1,003)	(1,143)
Total	<u>12,039</u>	<u>11,066</u>

Managing Agent fees consist of service fees paid or payable to the Managing Agent. Auditor fees were primarily for the audits of the Syndicate's annual and underwriting year accounts and the audits of the Lloyd's regulatory returns. Audit fees also include fees for the Syndicate's half year review of \$27,961. Non audit fees are for the actuarial review of the Syndicate's technical provisions and the preparation of the statements of actuarial opinion.

(7) Directors' Compensation and Staffing

Asta directors did not receive any compensation for their services during 2014 or 2013, nor did the directors participate on the Syndicate or have an interest in any of its contracts.

Asta employed an average of 10 people that worked for the Syndicate. The Managing Agent recharged the Syndicate for the payroll costs of one of these employees. Service fees paid to the Managing Agents as part of their Managing Agent fees included compensation for the other employees.

International Catastrophe Insurance Managers, LLC (ICAT Managers), a Delaware company, underwrites most of the Syndicate's insurance business. Boulder Claims, LLC (Boulder Claims), also a Delaware company and a wholly owned subsidiary of ICAT Managers (collectively ICAT), provides claims administration services to the Syndicate.

The Syndicate's staff compensation expense includes compensation made to ICAT Managers for a component of salary expense for executive underwriting staff, including the Active Underwriter, who work directly for the Syndicate.

Notes to the Annual Accounts (Continued)

31 December 2014

(7) Directors' Compensation and Staffing (Continued)

This table details the payroll recharges, included in administrative expenses under operating costs, to the Syndicate by category.

	2014 \$000	2013 \$000
Wages and salaries	412	383
Social security costs	21	22
Other pension costs	28	11
Total	<u>461</u>	<u>416</u>

Compensation to the Active Underwriter accounted for \$183,288 (\$157,489 in 2013) of the total payroll recharges.

An external fund manager provides investment services to the Syndicate.

(8) Other Financial Investments

	2014 \$000	
	Market value	Cost
Shares and other variable yield securities	369	369
Debt securities and other fixed income securities	73,599	73,592
Total	<u>73,968</u>	<u>73,961</u>

	2013 \$000	
	Market value	Cost
Shares and other variable yield securities	10,451	10,451
Debt securities and other fixed income securities	52,272	52,263
Total	<u>62,723</u>	<u>62,714</u>

The Syndicate holds its debt and other fixed-income securities in U.S. situs trust funds and the Lloyd's Dollar Trust Fund (the Syndicate's main operating account); all of these securities are listed. The U.S. situs trust funds protect the Syndicate's policyholders as required by U.S. regulators and are unavailable for use in the Syndicate's operations. The Syndicate did not write-down any of its investments during 2014 or 2013.

(9) Debtors Arising out of Direct Insurance Operations

	2014 \$000	2013 \$000
Amounts due from associated intermediaries	13,154	15,087
Amounts due from other intermediaries	84	36
Total	<u>13,238</u>	<u>15,123</u>

Notes to the Annual Accounts (Continued)

31 December 2014

(10) Overseas Deposits

Overseas deposits consist of funds contributed to joint trust funds which Lloyd's maintains to provide additional security to U.S. policyholders and third party claimants. The Syndicate can not direct the investment of these funds, which are also unavailable for use in its operations.

(11) Reconciliation of Members' Balances

	2014 \$000	2013 \$000
Members' balances at beginning of year	27,281	14,445
Profit for the financial year	32,549	24,634
Payments of profit to members' personal reserve fund	(15,202)	(11,639)
Other	(146)	(159)
Members' balances at end of year	<u>44,482</u>	<u>27,281</u>

Members participate in the Syndicate on an underwriting year basis. The Syndicate assesses its results and net assets for each underwriting year based on the policies incepting in that year for the membership of that year.

(12) Underwriting Year Account Payments of Profit to Members

The directors propose a \$26.3 million open year profit release to the members of the 2013 underwriting year. At the end of 2013, the directors proposed a \$12.4 million open year profit release to the members of the 2012 underwriting year. The Syndicate paid this amount in the second quarter of 2014.

The 2012 underwriting year is now closed. The Syndicate will pay a further and final profit distribution of \$1.1 million to members of the 2012 underwriting year in the second quarter of 2015.

	2014 \$000	2013 \$000
Release on open underwriting year	12,400	13,200
Final release / (collection) on closed underwriting year	2,981	(1,336)
Members agent fees	(179)	(225)
Payments of profit to members	<u>15,202</u>	<u>11,639</u>

Notes to the Annual Accounts (Continued)

31 December 2014

(14) Other Creditors

	2014 \$000	2013 \$000
Amounts owed to associated companies	667	428
Amounts owed to Managing Agent	190	9
Amounts due to auditors	—	32
Amounts due to others	5	257
Total	<u>862</u>	<u>726</u>

(15) Reconciliation of Profit on Ordinary Activities to Net Cash Inflow from Operating Activities

	2014 \$000	2013 \$000
Profit on ordinary activities after interest	32,549	24,634
Changes in market values and exchange rate effects	49	95
Increase / (Decrease) in general insurance technical provisions	678	(2,319)
Decrease in debtors	258	218
Increase in creditors	3,518	26
Net cash inflow from operating activities	<u>37,052</u>	<u>22,654</u>

(16) Analysis of Cash Flows for Headings Netted in the Cash Flow Statement

	2014 \$000	2013 \$000
Portfolio investments:		
Purchases of shares and other variable yield securities	(222,284)	(252,553)
Purchases of debt securities and other fixed income securities	(124,669)	(80,707)
Sales of shares and other variable yield securities	232,366	289,339
Sales of debt securities and other fixed income securities	103,363	32,661
Net cash outflow on portfolio investments	<u>(11,224)</u>	<u>(11,260)</u>

Purchases and sales of shares and other variable yield securities reflect overnight sweeps between the Syndicate's main operating account and the money funds where the cash is able to earn a higher return.

Notes to the Annual Accounts (Continued)

31 December 2014

(17) Movement in Opening and Closing Portfolio Investments Net of Financing

	2014 \$000	2013 \$000
Net cash inflow / (outflow) for the year	10,446	(473)
Cash flow:		
Portfolio investments	11,224	11,260
Overseas deposits	34	69
Movement arising from cash flows	21,704	10,856
Changes in market values	21	(32)
Total movement in portfolio investments net of financing	21,725	10,824
Portfolio investments net of financing:		
At 1 January	64,184	53,360
At 31 December	85,909	64,184

The Syndicate also has a \$35.0 million letter of credit facility, which has not been used. The Syndicate collateralised this facility with reinsurance balances recoverable and premiums receivable.

Notes to the Annual Accounts (Continued)

31 December 2014

(17) Movement in Opening and Closing Portfolio Investments Net of Financing (Continued)

The tables below summarise the movement in cash, overseas deposits, and portfolio investments.

	2014 \$000			
	At 1 January	Cash Flow	Changes in Market Values	At 31 December
Cash at bank and in hand	1,021	10,446	—	11,467
Overseas deposits	440	34	—	474
Portfolio investments:				
Shares and other variable yield securities	10,451	(10,082)	—	369
Debt securities and other fixed income securities	52,272	21,306	21	73,599
Total	<u>64,184</u>	<u>21,704</u>	<u>21</u>	<u>85,909</u>
	2013 \$000			
	At 1 January	Cash Flow	Changes in Market Values	At 31 December
Cash at bank and in hand	1,494	(473)	—	1,021
Overseas deposits	371	69	—	440
Portfolio investments:				
Shares and other variable yield securities	47,237	(36,786)	—	10,451
Debt securities and other fixed income securities	4,258	48,046	(32)	52,272
Total	<u>53,360</u>	<u>10,856</u>	<u>(32)</u>	<u>64,184</u>

Notes to the Annual Accounts (Continued)

31 December 2014

(18) Related Parties

Asta is the Managing Agent of the Syndicate.

This table details amounts expensed or payable to the Managing Agent.

	2014 \$000	2013 \$000
Managing Agent fees on insurance capacity	1,309	1,243
Service fees	3,188	3,546
Recharges (payroll costs and expenses)	210	72
Profit commissions	4,650	3,518
Total expenses	<u>9,357</u>	<u>8,379</u>
Balance payable (including expenses accrued but not yet due) to the Managing Agent at 31 December	<u>427</u>	<u>522</u>

Commissions paid or payable to ICAT for underwriting services totalled \$32.4 million (\$32.0 million in 2013), while fees paid or payable for claims administration services totalled \$1.3 million in 2014 (\$1.2 million in 2013) on \$125.4 million (\$118.9 million in 2013) of gross written premiums. The commission payable due to ICAT for underwriting service was \$4.9 million at 31 December 2014 (\$5.6 million at 31 December 2013), while \$114,917 was due at 31 December 2014 (\$132,804, at 31 December 2013) for claims administration services. From 1 January 2014 ICAT provided accounting services to the Syndicate for an annual fee of \$155,000.

ICAT is an indirect subsidiary of Paraline Group, Ltd (Paraline Group), a company registered in Bermuda that also provided 49.7% (50.9% for the 2013 underwriting year and 47.0% for 2012) of the Syndicate's insurance capacity through its indirectly owned Paraline and ICAT corporate members. Paraline Reinsurance, Ltd (Paraline Re), an indirectly owned Bermudian reinsurance company of Paraline Group supports the Paraline corporate member's participation on the Syndicate. Unrelated foreign reinsurers fully support the ICAT corporate members' participation. An affiliate of Paraline Group, Elliott CCM Limited, provided another 3.6% (3.7% for the 2013 underwriting year and 3.5% for 2012 underwriting year) of capacity.

The table below details the percentage of total Syndicate capacity provided by other parties by underwriting year.

	2014	2013	2012
General Insurance Corporation of India	—	—	5.0%
Hampden Agencies Limited	11.6%	11.3%	11.0%
IAT Reinsurance Company Ltd	8.5%	7.5%	7.0%
Labuan Re Underwriting Limited	14.6%	14.6%	14.5%
SCOR Underwriting Limited	12.0%	12.0%	12.0%
Total	<u>46.7%</u>	<u>45.4%</u>	<u>49.5%</u>

Notes to the Annual Accounts (Continued)

31 December 2014

(18) Related Parties (Continued)

A reinsurance affiliate of SCOR Underwriting Limited, SCOR Global P&C SE (SCOR Global), together with other reinsurers also provides layered, non-proportional catastrophe reinsurance without prepaid reinstatement to the Syndicate to protect against the occurrence of large catastrophes. SCOR Global's share of the Syndicate's catastrophe reinsurance coverage is 5.3% (5.6% before 1 April 2014), accounting for 4.7% (5.2% in 2013) of the Syndicate's overall reinsurance costs. The balance payable (including amounts accrued but not yet due) to SCOR Global at 31 December 2014 was \$450,724 (\$444,390 at 31 December 2013).

Before 1 April 2013, Paraline Re, a wholly owned subsidiary of Bermuda-based Paraline International, Ltd (Paraline International) together with other reinsurers provided layered, non-proportional catastrophe reinsurance premium protection to the Syndicate to cover potential reinstatement premiums. Paraline Re's share of this coverage was 14.7%, accounting for 2.5% of the Syndicate's overall reinsurance costs. The Syndicate paid a final adjustment premium of \$28,764 to Paraline Re in 2013.

Paraline CCM Limited is the beneficiary of a catastrophe reinsurance brokerage sharing agreement with the Syndicate and received \$0.8 million during the year. Paraline Re received \$0.2 million from the Syndicate under a similar agreement last year. The Syndicate has a payable to Paraline CCM Limited of \$221,587 at 31 December 2014.

Paraline International, a wholly owned subsidiary of Paraline Group, owns 30.21% of Asta's ultimate parent, Asta Capital Limited, a company incorporated in the U.K. and registered in England and Wales. Asta has an agreement with Paraline International to review and monitor the adherence of ICAT to the Syndicate's underwriting guidelines. The contingent commissions paid or payable to Paraline International for this oversight totalled \$2.8 million (\$1.1 million in 2013).

Asta is the Managing Agent for nine Lloyd's Syndicates. In addition to the Syndicate, Asta manages Syndicates 1686, 1729, 1897, 1910, 2357, 2525, 2526, and 6117 on behalf of third party capital providers that are independent of the Syndicate's capital providers. Asta also provides administrative services to syndicates and undertakes a number of ancillary roles for clients.

From time to time, syndicates managed by Asta enter into reinsurance contracts with one another. All such transactions are subject to Asta's internal controls which ensure that all are compliant with Lloyd's Related Party Byelaw provisions.

(19) Funds at Lloyd's

Lloyd's requires every member of the Syndicate to hold capital in trust, known as Funds at Lloyd's, to support their supplied insurance capacity. Lloyd's intends for these funds to mainly cover the participating members' underwriting liabilities if the Syndicate's assets prove to be inadequate. Paraline Group's corporate members held \$69.6 million of such funds in trust at 31 December 2014, while Elliott CCM Limited held another \$4.5 million. Since third parties supplied the rest of the funds, the directors did not disclose these funds in the accounts since they are not under the control of the Managing Agent or its affiliates; the Managing Agent, however, can make calls on these funds along with the funds provided by the Paraline Group and Elliott corporate members to meet liquidity requirements or settle claims.

Notes to the Annual Accounts (Continued)

31 December 2014

(20) Contingent Liabilities

a) Legal proceedings

Greater Heights, LLC, Brevard Neighborhood Development Coalition, Inc., and Fair Housing Continuum, Inc. (collectively, the Complainants) have filed two complaints with the United States Department of Housing and Urban Development against International Catastrophe Insurance Managers, Syndicate 4242, and Bass Underwriting (the Respondents). The Complainants allege that Respondents violated Title VIII of the Civil Rights Act of 1968 as amended by the Fair Housing Act of 1988.

The Complainants statement of facts regarding the alleged violation is based upon the cancellation of a commercial insurance policy issued by the Respondents to Greater Heights, LLC which was allegedly cancelled because more than 10% of the tenants at Greater Heights were Section 8 voucher holders. The Complainants allege that the cancellation of this policy was discriminatory based upon race and disability, and that Complainants were harmed as a result.

Based upon legal advice, the Respondents specifically deny that they have engaged in any violation of the Fair Housing Act and management does not believe that the outcome of this investigation will have a material adverse effect on Syndicate 4242's financial position, operating results, or cash flows.

The Syndicate is regularly involved in other legal proceedings in the ordinary course of business. The directors believe the outcome of these proceedings will not have a material adverse effect on the Syndicate's financial condition or future profitability.

(21) Subsequent Event

Management evaluated other events subsequent to the balance sheet date through 13 March 2015, the date the Syndicate issued these annual accounts, and determined that no other items require disclosure.