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ICAT Syndicate 4242

Syndicate Annual Report and Accounts

31 December 2016

Contents

Directors and Administration

Managing Agent

Asta Managing Agency Ltd

Directors

T A Riddell (Chairman)*
C V Barley
L Harfitt
A J Hubbard*
D J G Hunt
M D Mohn*
D F C Murphy*
S P A Norton
J W Ramage*
K Shah*
J M Tighe

Non Executive Directors*

Company Secretary

C Chow

Managing Agent's Registered Office

5th Floor
Camomile Court
23 Camomile Street
London
EC3A 7LL

Managing Agent's Registered Number

1918744

Active Underwriter

M H McConnell

Directors and Administration (Continued)

Primary Coverholder

International Catastrophe Insurance Managers LLC (ICAT)

Claims Administrator

Boulder Claims LLC

Investment Manager

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

N Sharif, KPMG LLP

Annual report of the Directors of the Managing Agent

The directors of the Managing Agent (the directors) present their report below, together with the audited financial statements for Syndicate 4242 (the Syndicate), for year ended 31 December 2016 on pages 19 to 53.

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 in accordance with Lloyd's Syndicate Byelaw No. 8 of 2005.

Results

The Syndicate generated profits of $13.5million ($29.6 million in 2015) on gross written premiums of $185.6 million ($169.4 million in 2015).

This table details the profits and related returns on insurance capacity for the 2014 closed underwriting year and the directors forecast for the Syndicate's two open underwriting years.

	Underwriting Years		
	2016 Open	**2015 Open**	**2014 Closed**
	$'000	$'000	$'000
Profit	7,130	26,753	30,970
Return on insurance capacity	5.2%	24.0%	31.2%

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 residential and small commercial risks 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, equipment breakdown, 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 assumes risk on a direct basis with appointed coverholders and on an inwards proportional reinsurance basis. International Catastrophe Insurance Managers, LLC (ICAT Managers) is the primary coverholder for the Syndicate.

The Syndicate contracts with certain wholly owned subsidiaries of Paraline Group, Ltd, a Bermuda based insurance organisation, for certain insurance services; these subsidiaries include 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.

Annual report of the Directors of the Managing Agent continued

ICAT Managers writes business for the Syndicate through its network of relationships with surplus line 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 59.4% (53.8% at 31 December 2015) 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 writes 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 U.S. Pacific Northwest, the U.S. Intermountain West, Alaska, the New Madrid area of the U.S., and Hawaii)

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

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 $1.9 million and an average premium of $4.5k. Small business policies account for 42.7% (46.2% in 2015) 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 $50.0 million, with an average value of $21.3 million and an average premium of $17.1k. Middle market policies account for 37.9% (39.5% in 2015) of the Syndicate's total business.

Annual report of the Directors of the Managing Agent continued

iii. The HBU provides coverage to homeowners via coverholder arrangements overseen by ICAT or by inwards reinsurance quota share agreements. Average insured values are $0.5 million with average annual premium of $1k. The HBU comprises:

   a. Binding Authority Agreements with third party coverholders to underwrite policies covering homes and small businesses against property losses, including those from hurricanes and other windstorms in the Eastern Seaboard, Gulf and Florida and earthquakes in certain areas of the U.S. ICAT controls and monitors this business on behalf of the Syndicate.

   b. Proportional reinsurance is provided to certain U.S. insurance companies covering personal lines property risks, primarily in California. These risks are generally subject to maximums of $2.5 million for each building. The Syndicate sets the appetite each calendar year and can scale down if necessary to ensure aggregate exposure is within tolerance.

   c. The Syndicate reinsures Hawaii homeowners for windstorm and earthquake risks subject to a maximum liability of $105.0 million for each catastrophe ($210.0 million in the aggregate.

These financial results include the acceptance and cession of business for Special Purpose Arrangement 6123 ("SPA 6123" or "the SPA"). This vehicle was formed in May 2015 to offer more capacity for ICAT to write MMBU accounts with capital sourced by a subset of Syndicate 4242 capital providers. The Syndicate 4242 financial statements are effectively grossed up for this capacity and include $18.8 million of written premium for 2016 compared to $6.6 million in 2015. Losses and commissions are also grossed up but have no profit effect on Syndicate 4242. SPA 6123 has its own allocated expenses and outwards reinsurance program as outlined in the SPA 6123 Annual Report.

Syndicate 4242 insurance capacity is £110.0 million ($136.4 million at 31 December), £15.0 million of which relates to business reinsured by SPA 6123 ($18.6 million at 31 December). Insurance capacity is a measure of the maximum gross premiums, net of acquisition costs that the Syndicate is eligible to write; the Syndicate wrote $132.0 million ($120.9 million in 2015) 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.

Annual report of the Directors of the Managing Agent continued

	2016 $'000	2015 $'000
Gross written premiums:		
Eastern Seaboard	29,639	27,890
Florida	61,098	56,842
Gulf Coast	38,658	33,863
Hawaii (includes direct and inward reinsurance premiums)	5,411	6,023
Earthquake (includes direct and inward reinsurance premiums)	50,796	44,748
Total gross written premiums	185,601	169,366
% of insurance capacity	96.8%	78.5%
Outward reinsurance premiums	(81,777)	(60,465)
Profit for the financial year	13,538	29,580
Members' balances	29,356	46,604
Net loss ratio*	33.9%	17.8%
Combined ratio (financial basis)*	86.8%	70.8%

Annual report of the Directors of the Managing Agent continued

**The net loss ratio is the ratio of net claims incurred to net premiums earned, while the combined ratio is the ratio of net claims incurred and net operating expenses to net premiums earned. Lower ratios represent better performance.*

Syndicate 4242 gross written premium grew by 10% due to expansion of the HBU and the increase in premium from SPA 6123. HBU is growing through the earthquake homeowner product that commenced in 2014 and contributed $13 million in 2016. HBU also benefited from a full year of writing for coverholder that was appointed mid-year 2015 with renewals for the year rolling on to the Syndicate. A full twelve months of writing is also the substantial driver for the growth with SPA 6123 which commenced writing in May 2015, although some momentum since launch is also contributing to growth. The market remains challenging, but the Syndicate believes it can grow responsibly with focus on key regions and accounts to achieve profitability whilst maintaining underwriting discipline.

Hurricane Matthew was a notable loss event during the year, but in line with what the Syndicate would expect for its appetite and portfolio. The storm tracked along the coastline of Florida and the southern states of the Eastern Seaboard before making landfall on 8th October in South Carolina as a Category 1 Hurricane. Losses from the hurricane are within tolerance and well below reinsurance attachment levels. Hurricane Matthew was the most significant storm affecting the U.S. in recent years and is the substantial reason for the reduced Syndicate profitability compared to prior years. Other losses for AOP and attritional catastrophe were in line with expectations.

Non-financial Key Performance Indicators

	2016	2015
Adherence to underwriting authority limits	100.0%	100.0%
Customer retention ratio	81.0%	83.7%

Annual report of the Directors of the Managing Agent continued

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 layered catastrophe reinsurance to protect against the adverse accumulation of the losses below from multiple policies as a result of large catastrophic events.

i. First event: Losses in excess of $40 million up to $690 million

ii. Second event: Losses in excess of $15 million up to $415 million

iii. Third event: Losses in excess of $10 million up to $80 million

The catastrophe reinsurance above provides $1,045.0 million of aggregate coverage. Included in the aggregate coverage is reinsurance to protect against an accumulation of losses from three catastrophic events. The shared limits provide coverage up to $80.0 million with varying xs points, also top coverage $135.0 million xs $415.0 million, maximum recoverable all sections $175.0 million.

If the Syndicate exhausts any of its catastrophe reinsurance, 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, 2016, the Syndicate had similarly layered catastrophe reinsurance to protect against large catastrophic events, each with losses in excess of $35.0 million up to $535.0 million ($785.0 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 – The Syndicate has attritional catastrophe reinsurance to protect against tornados, hail, and other windstorm events, 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 losses from other perils such as large fires. The Syndicate reinsures losses excluding flood, earthquake, windstorm or hail cover the Syndicates share of 100% limits xs $1.0 million for 100% ($250,000 for residential property) for each building up to $15.0 million and events damaging several buildings in the same location with losses in excess of $2.0 million up to $5.0 million. For multiple sinkhole collapse and terrorism events, total coverage is limited to $35.0 million. The Syndicate earns contingent profit commissions on this coverage equal to 25% of the excess of ceded premiums over deductions for underwriting expenses (equal to 35% of ceded premiums) and any claims, including adjustment expenses being paid under the coverage.

For properties reinsured before 1 January 2016, the Syndicate had similar coverage for losses in excess of $1 million ($250,000 for residential properties) for each building up to $15.0 million with a total coverage limit for multiple sinkhole collapse and terrorism events of $35.0 million.

SPA 6123 Coverage – In 2016, the Syndicate has variable quota share reinsurance, where it cedes up to 80% of the related written premiums on certain middle market business policies with total insured values of more than $10 million, subject to a limit of $5 million on each policy.

Before 1 January 2016, the Syndicate had similar variable quota share reinsurance, where it ceded up to 80% of the related written premiums on certain middle market business policies with total insured values of more than $10 million, subject to a limit of $5 million on each policy.

The Syndicate has proportional reinsurance to cover most of its general liability and equipment breakdown related liabilities and also purchases facultative AOP reinsurance for larger risks.

Future outlook

The Syndicate will continue with its strategy of prioritising capacity for the smaller limit accounts written through the PBU and HBU segments. Moderate growth is expected mainly through HBU with further growth from the Earthquake Homeowner product and the benefit of a full year of premium writings from homeowner coverholders appointed during the latter half of 2016.

Syndicate 4242 has announced plans to take small sized steps in expanding risk appetite beyond U.S. property catastrophe risks written with ICAT Managers. The Syndicate is committed to short tail business and opportunities will be reviewed with the long term strategic fit in mind. ICAT generated business, and the ICAT approach, will remain core to the Syndicate's operations.

Investments

The portfolio returned 0.61% for 2016, in line with the return on the benchmark. The income component of this return remained relatively stable during the year, with the capital component turning slightly negative in the second half of the year as US treasury yields rose.

Foreign exchange

Foreign exchange is not significant to the Syndicate, since the Syndicate transacts all of its business 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 loss. RDS include the events below.

i. Windstorm in the Northeastern U.S.

ii. Windstorm in the Carolinas

iii. Two separate Florida windstorms (Miami-Dade and Pinellas)

iv. Windstorm in the U.S. Gulf

v. Two separate California earthquakes (Los Angeles and San Francisco)

vi. New Madrid area of the U.S. earthquake

vii. Two separate Syndicate-specific scenarios (Mississippi windstorm and U.S. Pacific Northwest earthquake)

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 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.

The Syndicate, through ICAT sets and controls the underwriting authority of each of its underwriters. Underwriters adhere to daily monitored regional blueprints, which identify where the Syndicate's insurance capacity can be deployed. Underwriting guidelines alongside modellingand 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 on a periodic basis to ensure adherence to established underwriting authority limits. ICAT also conducts other underwriting audits on an ad-hoc basis and reviews significant risks written each month. The Managing Agent also has its own controls.

Annual report of the Directors of the Managing Agent continued

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 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 for the first, second, and third quarters, after considering the recommendation of the Reserve Committee (a subcommittee of the Board). The Managing Agent's Board approves the Syndicate's fourth quarter reserves.

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), storm surge coverage leakage. ICAT models every property in the Syndicate's book of business monthly using adjusted modelling parameters to address observed 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, which include inspections of every property, 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 Syndicate evaluates the probability of catastrophes using a catastrophe model that quantifies its hurricane and earthquake related loss exposures. ICAT developed the catastrophe model used by the Syndicate by applying its model adjustment methodology to a model from a major vendor to align the vendor model to the Syndicate's assessment of risk. The Syndicate applies this adjustment methodology because it estimates building vulnerability, storm surge 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 ICAT's methodology against alternate models from other major vendors.

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 a diversified group of 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. They also have business continuity and disaster recovery plans in place. 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 sold 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 significantly reduces this risk by maintaining high quality investments (rated AA or better on average by Standard & Poor's) with an average duration of one year or less in its investment portfolio to provide downside protection against increases in interest rates; accordingly, the Syndicate does not have material interest rate risk.

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 Great British Pound expenses; these expenses, however, 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 loss. The

Syndicate significantly limits this risk by purchasing short-term, high quality investments consisting mostly of money funds, commercial paper, and U.S. Treasury bills, and generally holding them to maturity.

Credit risk

Bankruptcy, liquidity problems, distressed financial condition, or the general effects of today's 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 12.3% (13.2% in 2015) of the premiums that the coverholders wrote for the Syndicate and 12.9% of premium balances due at 31 December 2016 (13.4% at 31 December 2015). 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 U.S. Dollar denominated collateral of $155.1 million from certain reinsurers at 31 December 2016 to secure their obligations. One reinsurer, Mutual Boiler Re, accounted for 64.2% of reinsurance balances recoverable at 31 December 2016 – at December 2015, no single reinsurer accounted for more than 18.5% of reinsurance balances recoverable. There were no catastrophe reinsurance recoveries outstanding at 31 December 2016. There were $0.2 million in outstanding AOP and liability recoveries on paid claims.

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. 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 Bank PLC 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 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 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

The Syndicate increased its insurance capacity to write business from £110.0 million ($136.4 million) to £115.0 million ($142.6 million) for the 2017 underwriting year, £15.0 million ($18.6 million) of which relates to business reinsured by SPA 6123 (2016: £15.0 million, $18.6 million).

The risks to UK economic growth remain significant mainly because of the UK's decision to leave the European Union ("EU") ("Brexit"). There is significant change and associated uncertainty ahead for the market which is difficult to anticipate as the terms of the UK's exit from the EU remain unclear. Until that happens, the market will need to plan carefully for all possible scenarios to mitigate the impact of Brexit on Lloyd's businesses.

EU membership and access to the single market has enabled underwriters at Lloyd's to underwrite insurance and reinsurance from all the other 27 member states on a cross-border basis. The underwriters operate under a "passport" system, which allows them to conduct business throughout the EU while being regulated and supervised by the PRA.

It is expected that Lloyd's will publish its final Brexit plan in the first quarter of 2017. Lloyd's has a dedicated team putting forward the argument to the UK government on behalf of the marketplace for retaining EU passporting, but has yet to decide on how this is achieved; either by a single insurance company or a branch solution.

Effective 1 January 2016, Lloyd's is subject to the Solvency II capital regime and Solvency I figures are no longer applicable from that date. Although the capital regime changed, it has not impacted the Solvency Capital requirement of the Syndicate, since the Syndicate calculated its requirement based on Solvency II principles.

Annual report of the Directors of the Managing Agent continued

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 $25.3million open year profit release to the members of the 2015 underwriting year.

Directors

Details of the Directors of the Managing Agent that were serving at the year end and up to the date of signing of the financial statements are provided on page 1. Changes to directors during the year were as follows:-

C V Barley	Appointed 27 April 2016
M D Mohn	Appointed 16 May 2016
K Shah	Appointed 1 October 2016
Y A Lancaster (nee Bouman)	Resigned 12 February 2016
G M J Erulin	Resigned 31 March 2016

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

Disclosure of information to the 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
21 March 2017

Statement of Managing Agent's responsibilities

The Managing Agent is responsible for preparing the Syndicate financial statements in accordance with applicable law and regulations.

Insurance Accounts Directive (Lloyds's Syndicate and Aggregate Accounts) Regulations 2008 requires the Managing Agent to prepare their Syndicates financial statements for each financial year. Under that law they have elected to prepare the financial statements in accordance with UK Accounting Standards and applicable law (UK Generally Accepted Accounting Practice), including FRS 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland".

Under Insurance Accounts Directive (Lloyds's Syndicate and Aggregate Accounts) Regulations 2008 the managing agent must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Syndicate and of the profit or loss of the Syndicate for that period. In preparing these financial statements, the Managing Agent are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements assuming there are no uncertainties surrounding the Syndicate's ability to continue to write business in the future as required to provide a true and fair view

The Managing Agent is responsible for keeping adequate accounting records that are sufficient to show and explain the Syndicate's transactions and disclose with reasonable accuracy at any time the financial position of the Syndicate and enable them to ensure that the financial statements comply with the Insurance Accounts Directive (Lloyds's Syndicate and Aggregate Accounts) Regulations 2008. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the company and to prevent and detect fraud and other irregularities.

The Managing Agent is responsible for the maintenance and integrity of the Syndicate and financial information included on the Syndicate's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Independent auditor's report

Independent auditor's report to the members of Syndicate 4242

We have audited the financial statements of Syndicate 4242 for the year ended 31 December 2016, as set out on pages 19 to 53. The financial reporting framework that has been applied in their preparation is applicable law and UK Accounting Standards (UK Generally Accepted Accounting Practice), including FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*.

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 auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Syndicate and 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 the Syndicate's financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit, and express an opinion on, the syndicate's financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

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

Opinion on financial statements

In our opinion the financial accounts:

- give a true and fair view of the Syndicate's affairs as at 31 December 2016 and of 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 matter prescribed by the Insurance Accounts Directive (Lloyd's Syndicate and Aggregate Accounts) Regulations 2008

In our opinion the information given in the Report of the Directors of the Managing Agent is consistent with the financial statements.

Independent auditor's report 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 requires us to report to you, if in our opinion:

- adequate accounting records have not been kept; or
- the financial statements are not in agreement with the accounting records; or
- we have not received all the information and explanations we require for our audit.

Timothy Butchart
For and on behalf of KPMG LLP, Statutory Auditor
Chartered Accountants
15 Canada Square
London, E14 5GL

21 March 2017

Income statement

Technical account – general business

For the year ended 31 December 2016

	Notes	2016 $'000	2015 $'000
Earned premiums, net of reinsurance:			
Gross premiums written	3	185,601	169,366
Outward reinsurance premiums		(81,777)	(60,465)
Net written premiums		103,824	108,901
Change in the gross provision for unearned premiums	14	(8,304)	(15,329)
Change in the provision of unearned premiums, reinsurers' share	14	5,058	7,227
Net change in provision for unearned premiums		(3,246)	(8,102)
Earned premiums, net of reinsurance		100,578	100,799
Allocated investment return transferred from the non-technical account	5	456	8
Claims incurred, net of reinsurance			
Claims paid			
• Gross amount		(21,466)	(17,216)
• Reinsurers' share		1,750	1,551
Claims paid		(19,716)	(15,665)
Change in the provision for claims:	14		
• Gross amount		(18,618)	(2,989)
• Reinsurers' share		4,239	706
Change in provision for claims		(14,379)	(2,283)
Claims incurred, net of reinsurance		(34,095)	(17,948)
Net operating expenses	6,7	(53,237)	(53,204)
Balance on technical account – general business		13,702	29,655

All operations relate to continuing activities.

The notes are on pages 25 to 53 form part of these financial statements

Income statement continued

Non-technical account - general business

For the year ended 31 December 2016

	Notes	2016 $'000	2015 $'000
Balance on technical account – general business		13,702	29,655
Investment income	5	423	155
Unrealised gains on investments	5	93	-
Investment expenses and charges	5	(60)	(93)
Unrealised losses on investments	5	-	(54)
Allocated investment return transferred to general business technical account	5	(456)	(8)
Other charges (loss on foreign exchange)		(164)	(75)
Profit for the financial year		13,538	29,580

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 Statement of Comprehensive Income.

The notes on pages 25 to 53 form part of these financial statements.

Statement of financial position

For the year ended 31 December 2016

	Notes	2016	2015
		$'000	$'000
ASSETS			
Investments:			
Other financial investments	8	91,949	94,066
Reinsurers' share of technical provisions	14		
Provision of unearned premiums		17,146	12,088
Claims outstanding		5,153	911
		22,299	12,999
Debtors:			
Debtors arising out of direct insurance operations	9	18,625	19,498
Debtors arising out of reinsurance operations	10	3,296	3,291
Other debtors		100	707
		22,021	23,496
Other assets:			
Cash and cash equivalents		1,233	737
Prepayments and accrued income:			
Accrued interest		1,708	39
Deferred acquisition costs	14	21,473	18,847
Other prepayments and accrued income		1,250	2,357
		24,431	21,243
Total assets		161,933	152,541

The notes on pages 25 to 53 form part of these financial statements.

Statement of financial position continued

For the year ended 31 December 2016

	Notes	2016 $'000	2015 $'000
MEMBERS' BALANCE AND LIABILITIES			
Capital and reserves			
Members' balances		29,356	46,604
Liabilities			
Technical provisions			
Provision for unearned premiums:			
Gross amount	14	74,231	65,928
Claims outstanding			
Gross amount	14	30,740	12,121
		104,971	78,049
Creditors			
Creditors arising out of direct insurance operations	11	-	32
Creditors arising out of reinsurance operations	12	17,994	13,295
Other creditors	15	5,149	3,853
		23,143	17,180
Accruals and deferred income		4,463	10,708
Total liabilities		161,933	152,541

The board of Asta Managing Agency Ltd approved Syndicate 4242's financial statements on pages 19 to 53 on 15 March 2017, which the Director below signed on the board's behalf.

David J G Hunt
Director
21 March 2017

The notes on pages 25 to 53 form part of these financial statements.

Statement of changes in Members' balances

For the year ended 31 December 2016

		2016 $'000	2015 $'000
Members' balances at beginning of year		46,604	44,482
Profit for the financial year		13,538	29,580
Payments of profit to members' personal reserve fund	13	(30,200)	(27,428)
Members' Agent fees		(141)	(184)
Non standard personal expenses (payments)		(445)	154
Members' balances at end of year		29,356	46,604

Members participate in Syndicate 4242 on an underwriting year basis. Syndicate 4242 assesses its results and net assets for each underwriting year based on the policies incepting in that year for the membership of that year.

The notes on pages 25 to 53 form part of these financial statements.

Statement of cash flows

For the year ended 31 December 2016

	Notes	2016 $'000	2015 $'000
Cash flows from operating activities			
Profit for the financial year		13,538	29,580
Adjustments to reconcile profit for the financial year to net cash provided by operation activities:			
Net losses on other financial investments and foreign exchange		-	79
Changes in operating assets and liabilities:			
(Increase) in reinsurers' share of gross technical provisions		(9,300)	(7,933)
Decrease/(Increase) in debtors		1,475	(7,882)
(Increase) in prepayments and accrued income		(3,188)	(5,061)
Increase in technical provisions		26,922	18,318
Increase in creditors		5,963	6,872
(Decrease)/Increase in accruals and deferred income, net of foreign exchange effects		(6,245)	2,385
Net cash provided by operating activities		29,165	36,358
Cash flows from investing activities			
Purchase of financial investments		(229,979)	(526,199)
Proceeds from sales and maturities of other financial investments		232,212	506,651
Change in overseas deposits		(116)	(82)
Net cash outflows from investing activities		2,117	(19,630)
Cash flows from financing activities			
Payments of profit to members' personal reserve fund	13	(30,200)	(27,428)
Payments of Members' Agents fees and other non-standard personal expenses		(586)	(30)
Net cash used in financing activities		(30,786)	(27,458)
Net increase/decrease in cash and cash equivalents		496	(10,730)
Cash and cash equivalents at beginning of year		737	11,467
Cash and cash equivalents at end of year		1,233	737

The notes on pages 25 to 53 form part of these financial statements.

Notes to the financial statements

For the year ended 31 December 2016

1. Basis of preparation

Statement of compliance

The directors of the Managing Agent (the directors) prepared these financial statements for Syndicate 4242 (the Syndicate) in compliance with The Insurance Accounts Directive (Lloyd's Syndicate and Aggregate Accounts) Regulations 2008 and Financial Reporting Standard 102, *The Financial Reporting Standard* (FRS 102) and Financial Reporting Standard 103, *Insurance Contracts* (FRS 103), being applicable United Kingdom (U.K.) Generally Accepted Accounting Practice (GAAP), and in accordance with the provisions of Schedule 3 of the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations relating to insurance companies.

The directors prepared these financial statements on the historical cost basis, except for certain financial instruments measured at fair value through profit or loss, and presented them in U.S. Dollars, which is the functional and presentational currency of the Syndicate.

As permitted by FRS 103, the Syndicate continues to apply the same accounting policies that it applied prior to this standard for its insurance contracts.

2. Accounting policies

Use of estimates

The preparation of financial statements in conformity with U.K. GAAP requires that the directors to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of income and expenses during the reporting period. Actual results could differ from those estimates. Significant items subject to such estimates and assumptions include:

(i) provision for claims outstanding (refer to claims incurred accounting policy),

(ii) expected policy cancellations;

(iii) accruals for contingent commissions under reinsurance contracts; and

(iv) estimates of future premium for binder contracts (refer to gross premiums accounting policy).

Accounting policies continued

Insurance contracts

Insurance contracts are contracts where the Syndicate (as an insurer or reinsurer) accepts significant insurance risk (risk arising from both underwriting risk and timing risk), from a policyholder or reinsured by agreeing to compensate them if a specified uncertain future event (the insured or reinsured event) adversely affects them. The Syndicate determines whether it has significant insurance risk by comparing the amount and timing of premiums, commissions, and claim settlement expenses paid with the amount and timing of such cash flows if the insured event did not occur. Insurance contracts can also transfer financial risk.

Once the Syndicate classifies a contract as an insurance contract, it remains an insurance contract for the remainder of its term, even if the insurance risk decreases significantly during this period, unless all rights and obligations extinguish or expire.

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 based on historical cancellation activity over the past two years. The Syndicate shows premiums gross of coverholder commissions and excludes taxes and fees levied on them.

Outward reinsurance premiums

Outward reinsurance premiums consist of premiums on outward reinsurance contracts with other insurers and reinsurers bound during the year to reduce the Syndicate's exposure to losses from catastrophes, all other property perils, and incidental liability claims. The Syndicate's catastrophe reinsurers also charge reinstatement premiums to restore reinsurance contracts to their full limits when large catastrophes occur that exhaust all or a portion of these limits. Reinsurance transactions do not relieve the Syndicate of its primary obligations to its policyholders.

Provisions 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, all other property peril, equipment breakdown, and general liability premiums evenly over the policy term. The Syndicate expenses related reinsurance premiums evenly over the contract term (remaining contract term for reinstatement premiums), or incidence of risk, if significantly different. The Syndicate also expenses the deferred premium balance on exhausted coverage when large catastrophes occur.

Provision for unexpired risks

At the balance sheet date, the Syndicate performs a liability adequacy test on its insurance liabilities less related deferred acquisition costs to ensure that the carrying value is adequate, using current estimates of future cash flows. If this test shows that the liabilities is inadequate, any deficiency is recognised as an expense to the profit or loss account initially by recognising an additional liability for claims provisions or recognising a provision for unexpired risks.

Accounting policies continued

The directors assess the provision for unexpired risks by class of business, after considering related investment returns. No provision for unexpired risks was recorded in 2015 or 2014.

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, all other property perils, equipment breakdown, and general liability claims, 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 30 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.

Accounting policies continued

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.

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.

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. Realised and unrealised gains and losses arising from changes in the fair value of investments are presented in non-technical profit and loss account in the period in which they arise. Investment management expenses consist of investment custodian and fund management fees.

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

Accounting policies continued

Net operating expense

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.

Investments

The Syndicates' investments consist of shares and other variable yield securities and debt and fixed income securities.

Fair value measurements of financial assets and liabilities

The Syndicate follows the recognition and measurement requirements of FRS 102 section 11 *Basic Financial Instruments* and section 12 *Other Financial Instruments*. All of the Syndicate's financial assets and liabilities are basic financial instruments.

The Syndicate measures its investments at fair value through profit or loss using valuation techniques that maximise the use of observable market data and minimise the use of unobservable market data. The Syndicate determines fair value based on assumptions that market participants would use in pricing an investment in the principal or most advantageous market. When considering market participant assumptions in its fair value measurements, the Syndicate uses the fair value hierarchy below to classify its investments.

- Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities.
- Level 2: other techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly.
- Level 3: techniques which use inputs which have a significant effect on the recorded fair value that are not based on observable market data.

Accounting policies continued

Fair value measurements of financial assets and liabilities continued

Where the determination of the fair value measurement is based on inputs from different levels of the fair value hierarchy, the Syndicate bases the entire fair value measurement on the lowest level input that is significant to the entire measurement. The Syndicate recognises transfers between levels of the fair value hierarchy when events or changes in circumstances causing the transfer occur.

The Syndicate carries all of its other financial assets and liabilities at cost.

Cash and cash equivalents

The Syndicates' cash and cash equivalents consist of cash at banks and in hand.

Offsetting

The Syndicate sets off and presents its financial assets and liabilities net where:

(i) each it and another party owes the other determinable amounts,

(ii) it has the right to set off the amount owed with the amount owed by the other party,

(iii) it intends to set off, and

(iv) the right of setoff is enforceable at law.

Foreign currency translation

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 1.24 to translate Sterling balances into U.S. Dollars at 31 December 2016 (1.48 at 31 December 2015).

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.

3. Segmental analysis

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

2016	Gross written premiums	Gross premium earned	Gross claims incurred	Gross operating expenses	Reinsurance balance	Total
	$'000	$'000	$'000	$'000	$'000	$'000
Fire and other damage to property	166,899	159,655	(38,763)	(51,664)	(58,406)	10,822
Third-party liability	625	536	(669)	(148)	99	(182)
Reinsurance accepted	18,077	17,106	(652)	(7,052)	(6,796)	2,606
Total	185,601	177,297	(40,084)	(58,864)	(65,103)	13,246

2015	Gross written premiums	Gross premium earned	Gross claims incurred	Gross operating expenses	Reinsurance balance	Total
	$'000	$'000	$'000	$'000	$'000	$'000
Fire and other damage to property	152,619	140,630	(20,008)	(49,091)	(42,942)	28,589
Third-party liability	484	375	(310)	(41)	(51)	(27)
Reinsurance accepted	16,263	13,032	113	(5,837)	(6,223)	1,085
Total	169,366	154,037	(20,205)	(54,969)	(49,216)	29,647

Included in the reinsurance balance are reinsurance commissions and profit participation of $5.6 million ($1.8 million in 2015).

Surplus lines wholesale brokers pay fire and other damage to property and third party liability 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 $63.4 million ($42.0 million in 2015).

4. Claims movement

The Syndicate's incurred claims, net of reinsurance, from past accident years developed favourably by $1.5 million during year (favourably by $0.3 million in 2015). This positive development of run-off losses during the year reflects loss reserve reductions on past events.

5. Investment return

	2016	2015
	$000	$000
Income from investments	299	153
Gains on realisation of investments	124	2
Unrealised gains on investments	93	-
Losses on realisation of investments	-	-
Unrealised losses on investments	-	(54)
Investment management expenses	(60)	(93)
Total	456	8

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.

	2016	2015
	$000	$000
Average funds available for investment	88,703	83,740
Investment returns	300	153
Investment yield	0.3%	0.2%

6. Net operating expenses

	2016	2015
	$000	$000
Acquisition costs	53,637	48,507
Change in deferred acquisition costs	(2,627)	(4,739)
Administration expenses	7,854	11,201
Reinsurance commissions and profit participation	(5,627)	(1,765)
Total	53,237	53,204

This table details administrative expenses included in net operating expenses.

	2016	2015
	$000	$000
Operating costs (includes Managing Agent recharges)	1,891	2,999
Managing Agent fees and profit commissions	5,389	7,933
Lloyd's membership costs	1,603	1,170
Auditor remuneration - audit fees	256	254
Legal and professional fees	355	60
Brokerage sharing	(1,640)	(1,215)
Total	7,854	11,201

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 financial statements 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 $63,180. Non audit fees of $64,125 are for the actuarial review of the Syndicate's technical provisions and the preparation of the statements of actuarial opinion.

7. Key management personnel compensation

The directors did not receive any compensation for their services during 2016 or 2015, nor did the directors participate on the Syndicate or have an interest in any of its contracts.

The Managing Agent 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 Agent 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 reimbursements to ICAT Managers for the recharged portion their underwriting and operations staff's salaries.

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

	2016	2015
	$000	$000
Wages and salaries	402	404
Social security costs and other pension costs	36	32
Total	438	436

Compensation to the Active Underwriter accounted for $225,655 ($212,511 in 2015) of the total payroll recharges.

An external fund manager provides investment services to the Syndicate.

8. Investments

	2016 $000 Fair value	2016 $000 Cost
Other financial investments:		
Shares and other variable yield securities	25,568	25,568
Debt securities and other fixed income securities	65,708	65,614
Deposits with credit institutions (overseas deposits)	673	673
Total	91,949	91,855

	2015 $000 Fair value	2015 $000 Cost
Other financial investments:		
Shares and other variable yield securities	15,150	15,150
Debt securities and other fixed income securities	78,360	78,318
Deposits with credit institutions (overseas deposits)	556	556
Total	94,066	94,024

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 totalling $32.6 million at 31 December 2016 ($31.6 million at 31 December 2015) protect the Syndicate's policyholders as required by U.S. regulators. 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 cannot direct the investment of these funds. Both the U.S. situs trust funds and joint trust funds are unavailable for use in the Syndicate's operations. The Syndicate did not impair any of its investments during 2016 or 2015.

There was no material change in fair value for financial instruments held at fair value (other than derivatives) attributable to own credit risk in the current or comparative period.

Investments continued

The tables below detail the placement in the fair value hierarchy of non-deposit related investments measured at fair value through profit or loss.

	2016 $000			
	Fair value measurements using			
	Level 1	Level 2	Level 3	Total
Shares and other variable yield securities	-	25,568	-	25,568
Debt securities and other fixed income securities	39,957	25,751	-	65,708
Deposits with credit institutions (overseas deposits)	411	262	-	673
Total	40,368	51,581	-	91,949

	2015 $000			
	Fair value measurements using			
	Level 1	Level 2	Level 3	Total
Shares and other variable yield securities	-	15,150	-	15,150
Debt securities and other fixed income securities	51,912	26,448	-	78,360
Deposits with credit institutions (overseas deposits)	433	123	-	556
Total	52,345	41,721	-	94,066

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

Included in the level 2 category are financial assets measured using a valuation technique based on assumptions that are supported by prices from observable current market transactions. For example, assets for which pricing is obtained via pricing services but where prices have not been determined in an active market, financial assets with fair values based on broker quotes, investments in private equity funds with fair values obtained via fund managers and assets that are valued using the Syndicate's own models whereby the significant inputs into the assumptions are market observable.

Included in the level 3 category, are financial assets measured using a valuation technique (model) based on assumptions that are neither supported by prices from observable current market transactions in the same instrument nor are they based on available market data. Therefore, unobservable inputs reflect the Syndicate's own assumptions about the assumptions that market participants would use in pricing the asset or liability (including assumptions about risk). These inputs are developed based on the best information available, which might include the Syndicate's own data.

9. Debtors arising out of direct insurance operations

	2016	2015
	$000	$000
Due from intermediaries (within one year)	18,625	16,177
Inter-syndicate loan	-	3,321
	18,625	19,498

10. Debtors arising out of reinsurance operations

	2016	2015
	$000	$000
Due from intermediaries (within one year)	3,296	3,291
	3,296	3,291

11. Creditors arising out of direct insurance operations

	2016	2015
	$000	$000
Direct Business - Intermediaries (within one year)	-	32
	-	32

12. Creditors arising out of reinsurance operations

	2016	2015
	$000	$000
Reinsurance ceded (within one year)	16,921	13,295
Reinsurance ceded (after one year)	1,073	-
	17,994	13,295

13. Underwriting year account payments of profit to members

The directors propose a $25.3 million open year profit release to the members of the 2015 underwriting year. At the end of 2015, the directors proposed a $27.6 million open year profit release to the members of the 2014 underwriting year. The Syndicate paid this amount in the second quarter of 2016. The 2014 underwriting year is now closed. The Syndicate will pay a further and final profit distribution of $3.4 million to members of the 2014 underwriting year in the second quarter of 2017.

	2016	2015
	$000	$000
Release on open underwriting year	27,600	26,300
Final release on closed underwriting year	2,600	1,128
Payment of profit to members' personal reserve fund	30,200	27,428

14. Technical provisions

	2016 Gross provisions $'000	2016 Reinsurance assets $'000	2016 Net $'000	2015 Gross provisions $'000	2015 Reinsurance assets $'000	2015 Net $'000
Claims outstanding						
Balance at 1 January	12,121	(914)	11,207	9,132	(208)	8,924
Claims incurred during current underwriting year	40,084	(5,989)	34,095	20,205	(2,257)	17,948
Paid claims during the year	(21,466)	1,750	(19,716)	(17,216)	1,551	(15,665)
Balance at 31 December	**30,740**	**(5,153)**	**25,587**	**12,121**	**(914)**	**11,207**
Unearned premiums						
Balance at 1 January	65,928	(12,088)	53,840	50,599	(4,861)	45,738
Change in unearned premiums	8,304	(5,058)	3,245	15,329	(7,227)	8,102
Balance at 31 December	**74,231**	**(17,146)**	**57,085**	**65,928**	**(12,088)**	**53,840**
Deferred acquisition costs						
Balance at 1 January	18,847	-	18,847	14,108	-	14,108
Change in deferred acquisition costs	2,626	-	2,626	4,739	-	4,739
Balance at 31 December	**21,473**	**-**	**21,473**	**18,847**	**-**	**18,847**

15. Other creditors

	2016	2015
	$000	$000
Amounts owed to other syndicate (funds withheld)	-	1,866
Amounts owed to associated companies	2,730	1,716
Amounts owed to Managing Agent	1,820	219
Amounts due to others	418	52
U.S. Federal excise taxes payable	181	-
Total	5,149	3,853

16. Related parties

Asta Managing Agency Ltd (Asta) is the Syndicate's Managing Agent.

From time to time, syndicates managed by Asta enter into (re)insurance 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. All transactions are entered into on an arms length basis.

This table details amounts expensed or payable to Asta.

	2016	2015
	$000	$000
Managing Agent fees on insurance capacity	1,157	1,297
Service fees	2,298	2,412
Recharges (expenses)	212	119
Profit commissions	1,934	4,226
Total expenses	5,601	8,054
Balance payable (including expenses accrued but not yet due) to the Managing Agent at 31 December	363	384

Commissions paid or payable to ICAT for underwriting services totalled $37.8 million ($38.0 million in 2015), while fees paid or payable for claims administration services totalled $1.7 million in 2016 ($1.4 million in 2015) on $149.0 million ($165.2 million in 2015) of gross written premiums. The commission payable due to ICAT for underwriting service was $6.0 million at 31 December 2016 ($5.6 million at 31 December 2015), while $184,821 was due at 31 December 2016 ($138,601 at 31 December 2015) for claims administration services. ICAT provides accounting and capital modelling services to the Syndicate for an annual fee of $181,753.

Related parties continued

ICAT is an indirect subsidiary of Paraline Group, Ltd (Paraline Group), a company registered in Bermuda that also provided 31.9% (33.7% for the 2015 underwriting year and 33.1% for 2014) 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 1.7% (3.0% for the 2015 underwriting year and 3.6% for 2014 underwriting year) of capacity.

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

	2016	2015	2014
Everest Corporate Member Limited	6.7%	8.1%	8.1%
Hampden Agencies Limited (MAPA 7217)	11.6%	11.6%	11.6%
IAT CCM Limited	9.0%	8.5%	8.5%
Labuan Re Underwriting Limited	14.6%	14.6%	14.6%
SCOR Underwriting Limited	11.9%	12.0%	12.0%
Taiping Re UK Ltd	9.0%	8.5%	8.5%
Securis LCM Limited	3.5%	0%	0%
Total	66.4%	63.3%	63.3%

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 to the Syndicate to protect against the occurrence of large catastrophes. SCOR Global's share of the Syndicate's catastrophe reinsurance coverage is 5.1% (3.3% in 2015), accounting for 5.7% (3.6% in 2015) of the Syndicate's overall reinsurance costs. The balance payable (including amounts accrued but not yet due) to SCOR Global at 31 December 2016 was $488,057 ($230,449 at 31 December 2015).

An affiliate of Paraline Group, Pendulum Re II, Ltd, indirectly participates in the Syndicate's shared limit catastrophe reinsurance placement through a quota share retrocession agreement with a segregated cell of a Bermudian reinsurance company that reinsures half of the placement.

Paraline CCM Limited is the beneficiary of a catastrophe reinsurance brokerage sharing agreement with the Syndicate and received $2.4 million during the year ($0 million in 2015). The balance payable (including amounts accrued but not yet due) to Paraline CCM Limited was $200,497 million at 31 December 2016 ($1.4 million at 31 December 2015).

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 $1.1 million ($4.2 million in 2015).

Related parties continued

Pursuant to an inter-syndicate loan deed between the Syndicate and SPA 6123, the Syndicate may advance up to $10.0 million to SPA 6123; such advances accrue interest at an annual rate equal to the greater of:

(a) the Six Month U.S. Treasury Bill rate at the date of the advance, or

(b) the Syndicate's average investment yield earned during the period of the advance.

At 31 December 2016, the Syndicate held a loan receivable balance from SPA 6123 of $5.8 million (including accrued interest of $422), and included in debtors arising out of direct insurance operations. The Syndicate also owed SPA 6123 $6.8 million at 31 December 2016.

During 2016 Asta was the managing agent for eight Syndicates and three Special Purpose Arrangements. Syndicate 1686, 1729, 1897, 1910, 2357, 2525, 2786 and 4242 as well as Special Purpose Arrangements 6117, 6123 and 6126 were managed on behalf of third party capital providers.

On 7 February 2017, Syndicate 1910 and SPA 6117 migrated to Argo Managing Agency Limited.

On 1 January 2017, Asta took on management of Syndicate 2689 and Syndicate 5886.

The agency also provides administrative services to Syndicates and undertakes a number of ancillary roles for other clients.

The Financial Statements of the Managing Agency can be obtained by application to the Registered Office (see page 1).

17. Funds at Lloyd's

The Society of 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 $22.9 million of such funds in trust at 31 December 2016, while Elliott CCM Limited held another $3.1 million. Since third parties supplied the rest of the funds, the directors did not disclose these funds in the financial statements 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.

18. Contingent liabilities

The Syndicate is regularly involved in 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.

19. Risk management

a) Governance framework

The Syndicate's risk and financial management framework aims to protect member capital from events that might otherwise prevent the Syndicate from meeting its policyholder obligations, while maximising the returns to its members. The directors recognise the critical importance of having efficient and effective risk management systems and processes in place.

Asta maintains a risk management function for the Syndicate with clear terms of reference from the Syndicate Board (the Board) that it appoints and from the Board's committees and subcommittees; Asta supplements this with a clear organisational structure with documented authorities and responsibilities from the Board to ICAT, who performs a majority of the Syndicate's activities. Lastly, the Syndicate policy framework sets its risk management and control and business conduct standards for operations. Asta reviews and monitors each policy to ensure compliance with the policy throughout the Syndicate and by ICAT.

The Board approves the Syndicate's risk management policies and meets regularly to approve any commercial, regulatory, or organisational requirements of such policies; these policies define the identification of risk and its interpretation to ensure the appropriate quality and diversification of assets, align the underwriting and reinsurance strategies to the Syndicate's goals, and specify any reporting requirements. The Board places significant emphasis on the assessment and documentation of risks and controls, including the quantification of the Syndicate's risk appetite.

b) Capital management

Capital framework at Lloyd's

The Prudential Regulatory Authority (PRA) under the Financial Services and Markets Act 2000, and in accordance with the Solvency II Framework, regulates Lloyd's.

Within this supervisory framework, Lloyd's applies capital requirements at member level and centrally to ensure that overall Lloyd's market complies with the requirements of Solvency II, and beyond that to meet its own financial strength, license, 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 overall and member level only, not at the syndicate level, Accordingly, the directors have not disclosed a capital requirement for the Syndicate in these financial statements.

Lloyd's capital setting process

In order to meet Lloyd's requirements, each syndicate must 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 syndicate must also calculate its SCR at the same confidence level, but reflecting uncertainty over a one year time horizon (one year SCR) for Lloyd's to use in meeting the requirements of Solvency II. The Lloyd's Capital and Planning Group reviews and approves the SCRs of each syndicate.

Risk management continued

A syndicate may be comprised of one or more underwriting members of Lloyd's. Each member is liable for its own share of underwriting liabilities on the syndicates on which it is participating, but not other members' shares. Accordingly, the capital requirements that Lloyd's sets for each member operate on a similar basis. Lloyd's determines each member's SCR by the sum of the member's share of the syndicate SCR 'to ultimate'. Where a member participates on more than one syndicate, Lloyd's gives a credit for diversification to reflect the spread of risk, but consistent with determining an SCR which reflects the capital requirement to cover a 1 in 200 loss 'to ultimate' for that member. Over and above this, Lloyd's applies a capital uplift to the member's capital requirement, known as the Economic Capital Assessment (ECA). The purpose of this uplift, which is a requirement of Lloyd's not Solvency II, is to meet Lloyd's financial strength, license, and ratings objectives. The capital uplift applied for 2016 was 35% of the member's SCR 'to ultimate'.

Provision of capital by members

Each member may provide capital to meet its ECA either by assets held in trust by Lloyd's specifically for that member (Funds at Lloyd's), assets held and managed within a syndicate (funds in syndicate), or as the member's share of the members' balances on each syndicate on which it participates. Accordingly, the ending members' balances reported in the Statement of Changes in Members' Balances on page 23, represent resources available to meet members' and Lloyd's capital requirements.

c) Insurance risk

Insurance 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 insurance risk by basing its risk appetite on its maximum loss tolerance, geographically diversifying its business, and using appropriate underwriting processes, which include inspections of every property, to guide the pricing and acceptance of risks; this helps to ensure that premiums cover the expected levels of loss.

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 loss.

ICAT developed the catastrophe model that the Syndicate uses to set its overall EP loss exposure limits by adjusting a model from a major vendor to better align it to the Syndicate's assessment of risk. ICAT's model adjustment methodology more precisely estimates building vulnerability, storm surge coverage leakage, losses from inland risks and coastal risks, and landfall frequency and severity than the standard vendor model. The Syndicate validates the results from ICAT's methodology against alternate models from other major vendors. ICAT uses its model adjustment methodology to model every property in the Syndicate's book of business monthly. 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.

Risk management continued

The Syndicate monitors EP estimated gross losses and balances the offering of new and renewal accounts between low and high loss-driving areas. The Syndicate sets its tolerance for All Other Peril (AOP) losses at the building and location level. ICAT also monitors the Syndicate's loss exposures against its risk appetite using RDS modelling. RDS include the events below.

(i) Windstorm in the Northeastern U.S.

(ii) Windstorm in the Carolinas

(iii) Two separate Florida windstorms (Miami-Dade and Pinellas)

(iv) Windstorm in the U.S. Gulf

(v) Two separate California earthquakes (Los Angeles and San Francisco)

(vi) New Madrid area of the U.S. earthquake

(vii) Two separate Syndicate-specific scenarios (Mississippi windstorm and U.S. Pacific Northwest earthquake)

The table below shows the hypothetical estimated gross losses after the application of the Syndicate's proportional reinsurance arrangement with SPA 6123, but before any other reinsurance, arising out of the RDS listed above based on the Syndicate's in-force exposures at 31 December 2016.

	Estimated gross losses $000
Windstorm in the North-eastern U.S.	163,941
Windstorm in the Carolinas	182,664
Florida windstorm (Miami-Dade)	274,653
Florida windstorm (Pinellas)	278,240
Windstorm in the Gulf of Mexico	280,261
California earthquake (Los Angeles)	337,433
California earthquake (San Francisco)	293,778
New Madrid area of the U.S. earthquake	120,250
Syndicate-specific scenario (Mississippi windstorm)	118,989
Syndicate-specific scenario (U.S. Pacific Northwest earthquake)	231,462

Also, the Syndicate periodically evaluates and adjusts its reinsurance protection to manage its overall retention of insurance risk. The Syndicate has layered catastrophe reinsurance from a diversified group of secure reinsurers among other reinsurance to protect it against an adverse accumulation of the losses from multiple policies as a result of catastrophic events, each with losses of up to $690.0 million ($1,045.0 million in the aggregate). This reinsurance helps to limit the Syndicate's risk of insolvency from a single large catastrophe or multiple smaller catastrophes.

Risk management continued

ICAT controls the underwriting of the Syndicate's business, including the underwriting of original risks for all of Syndicate's inward reinsurance. ICAT sets and controls the underwriting authority of each of its underwriters. 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 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 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 significant risks written each month. Asta also has its own controls.

Asta has a governance structure in place to monitor the underwriting and loss exposure management controls of ICAT. 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.

Asta 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 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.

Risk management continued

The Syndicate hires 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 Asta 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).

Risk management continued

The tables below detail the Syndicate's liabilities for claims outstanding by class of business.

	2016		
	Gross $000	Reinsurance $000	Net $000
Fire and other damage to property	29,565	(4,213)	25,352
Third party liability	1,175	(940)	235
Reinsurance accepted	-	-	-
Total	30,740	(5,153)	25,587

	2015		
	Gross $000	Reinsurance $000	Net $000
Fire and other damage to property	11,234	(599)	10,635
Third party liability	390	(312)	78
Reinsurance accepted	497	-	497
Total	12,121	(911)	11,210

The liabilities in the tables above may be significantly greater or less than the ultimate cost of settling the associated claims; this level of uncertainty varies by class of business. The Syndicate considers a five percent increase or decrease in the ultimate cost of settling its outstanding claim liabilities reasonably possible at the balance sheet date.

The tables below show how a five percent increase or decrease in net claim liabilities would affect the Syndicate's profit for the financial year and its members' balances.

	2016	
	Five percent increase $000	Five percent decrease $000
Fire and other damage to property	(1,267)	1,267
Third party liability	(12)	12
Reinsurance accepted	-	-
Total	(1,279)	1,279

	2015	
	Five percent increase $000	Five percent decrease $000
Fire and other damage to property	(532)	532
Third party liability	(4)	4
Reinsurance accepted	(25)	25
Total	(561)	561

Risk management continued

The tables below show the Syndicate's cumulative incurred claims development, including both claims notified and IBNR for each underwriting year, together with the cumulative payments to date on a gross and net of reinsurance basis at the balance sheet date.

Underwriting year	2011 $000	2012 $000	2013 $000	2014 $000	2015 $000	2016 $000	Total
Estimate of cumulative claims incurred:							
At end of underwriting year	8,340	14,929	6,794	5,822	12,074	25,710	25,710
One year later	13,985	23,172	11,080	13,749	26,304		26,304
Two years later	11,569	22,847	11,459	13,627			13,627
Three years later	11,534	21,260	10,239				10,239
Four years later	11,500	21,094					21,094
Five years later	12,925						12,925
Less cumulative paid	(12,724)	(21,094)	(10,210)	(11,536)	(17,925)	(5,672)	(17,161)
Liability for gross outstanding claims (2011 to 2016)	201	0	29	2,091	8,380	20,037	30,738
Liability for gross outstanding claims (2010 and before)	2	-	-	-	-	-	2
Total							30,740

Underwriting year	2011 $000	2012 $000	2013 $000	2014 $000	2015 $000	2016 $000	Total
Estimate of cumulative net claims incurred:							
At end of underwriting year	8,144	14,695	6,634	5,594	10,862	22,227	22,227
One year later	13,505	22,151	10,980	12,472	22,689		22,689
Two years later	10,997	21,868	11,359	12,247			12,247
Three years later	10,974	20,281	10,139				10,139
Four years later	10,940	20,115					20,115
Five years later	11,879						11,879
Less cumulative net paid	(11,678)	(20,115)	(10,110)	(10,558)	(15,988)	(5,263)	(73,711)
Liability for net outstanding claims (2011 to 2016)	201	0	29	1,690	6,701	16,964	25,585
Liability for net outstanding claims (2010 and before)	2	-	-	-	-	-	2
Total							25,587

Risk management continued

The uncertainty associated with the ultimate claims experience of an underwriting year is greatest when the underwriting year is at an early stage of development and the margin for future experience potentially being more adverse than assumed is at its highest. As claims develop, and the ultimate cost of the claims becomes more certain, the relative level of margin should decrease. Due, however, to the uncertainty inherent in the claims estimation process, initial reserves may not always be in a surplus.

d) Financial risk

(i) Market risk

Market risk is the risk that the fair value or future cash flows of the Syndicate's financial assets will fluctuate because of changes in the market. Market risk consists of the three risks below.

1. *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 sold 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 significantly reduces this risk by maintaining high quality investments (rated AA or better on average by Standard & Poor's) with an average duration of one year or less in its investment portfolio to provide downside protection against increases in interest rates; accordingly, the Syndicate does not have material interest rate risk.

2. *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 Great British Pound expenses; these expenses, however, do not create material currency risk for the Syndicate. The Syndicate has no exposure to other currencies.

3. *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 loss. The Syndicate significantly limits this risk by purchasing short-term, high quality investments consisting mostly of money funds, commercial paper, and U.S. Treasury bills, and generally holding them to maturity; accordingly, the Syndicate does not have material investment price risk.

Risk management continued

(ii) Credit risk

Credit risk is the risk that other parties, including issuers of investments, fail to honor their obligations to the Syndicate.

Asta delegates the management of funds under its control in the U.S. situs trust funds and the Lloyd's Dollar Trust Fund to an external fund manager, New England Asset Management (NEAM). Asta, 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.

Bankruptcy, liquidity problems, distressed financial condition, or the general effects of today's 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 may affect the coverholders' ability to pay the premiums they in turn owe to the Syndicate. No single agent, broker, or policyholder accounted for more than 12.3% (13.1% in 2015) of the premiums that the coverholders wrote for the Syndicate and 13.4% of premium balances due at 31 December 2016 (13.4% at 31 December 2015). 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 the risk of reinsurers failing to honor their obligations 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 U.S. Dollar denominated collateral from the reinsurer to secure their reinsurance obligations. The Syndicate had collateral of $155.1 million from certain reinsurers at 31 December 2016 (2015: $173.9 million) to secure their obligations. One reinsurer, Mutual Boiler Re, accounted for 64.2% of reinsurance balances recoverable at 31 December 2016 – at December 2015, no single reinsurer accounted for more than 18.5% of reinsurance balances recoverable. There were no catastrophe reinsurance recoveries outstanding at 31 December 2016. There were however, $189,690 in outstanding AOP and liability recoveries on paid claims, $121,729 of which the Syndicate collected on 16 January, 2017.

Risk management continued

The tables below show the maximum exposure that the Syndicate's assets have to credit risk, before applying any obtained collateral.

2016		**$'000**		
	Neither past due or impaired	**Past due**	**Impaired**	**Total**
Other financial investments	91,949	-	-	91,949
Reinsurers' share of claims outstanding	5,153	-	-	5,153
Debtors arising out of direct insurance operations	18,625	-	-	18,625
Debtors arising out of reinsurance insurance operations	185	-	-	185
Other debtors	44,788			44,788
Cash and cash equivalents	1,233	-	-	1,233
Total	161,933	-	-	161,933

2015		**$'000**		
	Neither past due or impaired	**Past due**	**Impaired**	**Total**
Other financial investments	94,066	-	-	94,066
Reinsurers' share of claims outstanding	911	-	-	911
Debtors arising out of direct insurance operations	19,498	-	-	19,498
Debtors arising out of reinsurance insurance operations	2,415	876	-	3,291
Other debtors	707	-	-	707
Cash and cash equivalents	737	-	-	737
Total	118,334	876	-	119,210

Past due balances were less than three months past due at 31 December.

Risk management continued

The tables below classify the exposure that the Syndicate's assets have to credit risk by the Standard & Poor's credit ratings of the investments and parties involved.

2016				$'000		
	AAA	AA	A	BBB	Not Rated	Total
Other financial investments	51,804	39,997	134	14	-	91,949
Reinsurers' share of claims outstanding	-	127	5,026	-	-	5,153
Debtors arising out of direct insurance operations	-	-	-	-	18,625	18,625
Debtors arising out of reinsurance operations	-	-	185	-	-	185
Other debtors	-	-	-	-	44,788	44,788
Cash and cash equivalents	-	-	1,233	-	-	1,233
Total	51,804	40,124	6,578	14	63,413	161,933

2015				$'000		
	AAA	AA	A	BBB	Not Rated	Total
Other financial investments	67,074	26,878	97	17	-	94,066
Reinsurers share of claims outstanding	-	55	856	-	-	911
Debtors arising out of direct insurance operations	-	-	-	-	19,498	19,498
Debtors arising out of reinsurance operations	-	3	1,978	-	1,310	3,291
Other debtors	-	-	-	-	707	707
Cash and cash equivalents	-	-	737	-	-	737
Total	67,074	26,936	3,668	17	21,515	119,210

Not rated reinsurers fully collateralise their reinsurance balances to the Syndicate.

(iii) Liquidity risk

Liquidity risk is the risk that the Syndicate may not have enough 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. 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.

Risk management continued

The tables below summarise the Syndicate's future expected cash obligations on its undiscounted liabilities, including payments of its outstanding claim liabilities based on historical settlement patterns.

2016	$'000				
	Up to a year	1-3 years	3-5 years	More than 5 years	Total
Claims outstanding	20,945	8,772	1,016	7	30,740
Creditors arising out of insurance operations	-	-	-	-	-
Creditors arising out of reinsurance operations	16,839	1,155	-	-	17,994
Other creditors	5,149	-	-	-	5,149
Total	42,933	9,927	1,016	7	53,883

2015	$'000				
	Up to a year	1-3 years	3-5 years	More than 5 years	Total
Claims outstanding	8,626	3,365	126	4	12,121
Creditors arising out of insurance operations	32	-	-	-	32
Creditors arising out of reinsurance operations	13,295	-	-	-	13,295
Other creditors	1,987	1,866	-	-	3,853
Total	23,940	5,231	126	4	29,301

20. Subsequent events

The directors evaluated other events subsequent to the balance sheet date through 21 March 2017, the date the Syndicate issued these financial statements, and determined that no other items require disclosure.