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Syndicate 2012

Annual Report and Accounts
For the year ended 31 December 2018

Contents

Strategic Report

The Directors of Arch Underwriting at Lloyd's Ltd ("AUAL", "the Managing Agent") present their annual report and financial statements of managed Syndicate 2012 (the "Syndicate") for the year ended 31 December 2018.

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

Principal Activities

The Syndicate 2012 currently underwrites Casualty, Directors and Officers liability, Marine, Onshore and Offshore Energy, Professional Lines, Property, Personal Accident and Private Medical Insurance, Travel, Reinsurance and Terrorism.

Business Review

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

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

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

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

The Managing Agent has subsidiary undertakings incorporated in Australia and the United Kingdom. Arch Underwriting at Lloyd's (Australia) Pty Ltd, Arch Underwriting Agency (Australia) Pty Ltd and Axiom Underwriting Agency Limited ("Axiom") which are licensed to trade as Lloyd's service companies with authority to bind risks on behalf of Syndicate 2012. The focus for 2018 has continued to be the development of infrastructure and portfolios of profitable business.

On 1 October 2018 the Managing Agent sold Arch Underwriting Managers at Lloyd's (South Africa) (Pty) Ltd ("AUMALSA"). All liabilities prior to disposal will be run off by the Syndicate 2012.

Strategic Report *(continued)*

Business Review *(continued)*

Review of the Business

The Syndicate recorded an underwriting profit before investment income of £4.0m (2017: loss £24.4m) mainly driven by the favourable prior year releases and total comprehensive loss of £0.9m (2017: loss £26.9m) driven by a non- technical loss of £4.9m. The components are described below:

	2018		2017	
Key Performance Information and Metrics	£m	%	£m	%
Gross premiums written	232.0		199.9	
Net premiums written	170.1		146.4	
Earned premiums, net of reinsurance	170.3		151.5	
Claims incurred, net of reinsurance	-97.0	*56.9*	-107.1	*70.7*
Net operating expenses	-69.3	*40.7*	-68.8	*45.4*
Allocated investment income	0.2		-0.2	
Balance on technical account for general business	4.0		-24.4	
Investment return and foreign exchange	-5.0		-2.3	
Total loss for the year	-0.8		-26.9	

Gross Written Premiums

Gross written premiums of £232.0m are 16% higher than 2017. During 2018 the Syndicate continued its strategy of reducing the number of existing smaller coverholder arrangements within the portfolio, with the longer-term objective of building a broader base of in-house SME products. The underwriting conditions have been difficult in 2018 and the continued focus for Syndicate 2012 is to write profitable business.

The main growth for Syndicate 2012 in 2018 has been from the Australia and New Zealand travel binder which has written £37.1m in 2018 (£30.3m in 2017). This binder started for the first time in November 2015 and has become a significant part of the Syndicate's portfolio.

Incurred Claims

Losses and loss adjustment expenses are £10.1m lower than in 2017 resulting in a decrease in the loss ratio from 70.7% to 56.9%. The main driver for the decrease is due to release of reserves in the period, in respect of the three hurricanes, Harvey, Irma and Maria.

Operating Expenses

Net operating expenses of £69.3m (2017: £68.8m) are £0.5m higher than 2017. The acquisition expenses are £2.8m higher than in 2017 due to the increase in premiums. The acquisition ratio however decreased by 0.1% to 27.5% from 27.6% in 2017. The other operating expenses are £2.3m lower in 2018 at £21.6m which contributed towards a decrease in the operating expense ratio to 12.7% (15.7% in 2017) as well as the higher net earned premium.

Strategic Report *(continued)*

Corporate and Social Responsibility

The Board recognises the importance of managing the impact of the Syndicate's activities and takes care to maintain ethical standards and integrity in the conduct of our business.

The Arch Capital Group Ltd ("ACGL") maintains a Code of Business Conduct, which describes our ethical principles and includes policies designed to assist in preventing violations of the Code and to allow the Syndicate to respond appropriately to any actual or potential violations. To help set the standards of behaviour expected from all staff, the Syndicate provides a training course on the Code intended to help guide employees in the way that they conduct business.

The Syndicate is committed to providing equal opportunities to potential and actual employees in all aspects of employment. Our employment policies are not unfairly discriminatory on any grounds relating to selection, training, career development or any other employment matters.

Our success depends upon having highly capable people who fit well with the Syndicate's culture of performance, accountability, teamwork and ethical conduct. Staff are encouraged to continue professional education and each employee is encouraged to execute a personal development plan with their managers.

At the end of 2018, Syndicate had 87 (2017: 80) staff in London. To ensure we maintain high performance standards across the organisation, we conduct detailed annual appraisals focusing on identifying skills gaps and ensuring professional capabilities are maintained and enhanced.

Risk management strategy and risk appetite

The Syndicate has a set of risk appetite statements that are appropriate for its individual business model and strategy. Risk appetite statements setting out clear descriptions detailing appropriate levels of risk are in place for each material area of risk. Each of these statements is supported by a set of key risk indicators for detailed monitoring which are regularly reviewed and escalated where appropriate through the governance structure to the Board. Key risk indicators are set at levels that ensure sufficient remedial actions are put in place to ensure the Syndicate responds early to emerging threats. Risk appetites are reviewed, at a minimum, annually by the Board to ensure that the Syndicate retains full coverage over its risks.

The table below sets out our strategic risk objectives and shows, at a high level, examples of corresponding appetite statements:

Strategic risk objective	***Risk appetite statement***
Maintain capital adequacy	Maintain sufficient capital to a defined target
Deliver stable earnings	Profitability over a defined period
Stable and efficient access to funding and liquidity	Cash outflows met under stress
Maintain stakeholder confidence	No appetite for material reputational, legal or regulatory risks

Strategic Report *(continued)*

Risk management strategy and risk appetite *(continued)*

The aim of the risk framework is to provide a robust, proportionate, proactive and forward-looking process for risk management across the Syndicate. A central component of this framework is the Syndicate's policies and minimum standards, which inform the business as to how it is required to conduct its activities and risk management processes to remain within risk appetite. The Syndicate employs a number of risk tools to manage and monitor risk. The output of our risk management activities is thoroughly tested and reported upon both internally and externally.

The policies and minimum standards cover all key risks to which the Syndicate is exposed. Each policy is supported by minimum standards which set out the minimum level of risk management and other corporate and personal behaviours.

The Syndicate incorporates the identification, assessment, management, control, reporting and mitigation of risk as part of our daily operations. We believe the strengths of our risk framework are:

- Strong culture and risk leadership underpinned by training of our people;
- Engagement with the business;
- Embedded risk management processes, linking risk and capital;
- Quantitative approach to risk analysis through use of a robust economic capital model;
- Qualitative risk assessment and management information; and
- Influencing decision-making and shaping behaviours, via the provision of accurate, timely and relevant risk advice and challenge.

The Syndicate's risk management, internal audit, and compliance processes are coordinated to ensure that their respective activities are effective and complementary.

Strategic Report *(continued)*

Principal risks and uncertainties

The Syndicate writes products that are subject to a number of uncertainties and risks. It is a key role of the risk function to ensure that these risks have been identified, measured and considered throughout the business.

Principal risks	Impact	Strategy, management and mitigation
Strategic risk The economic climate could put at risk our ability to meet our strategic objectives in the areas of distribution, pricing, claims, costs, and international diversification. We may fail to execute our ongoing strategic plan, and the expected benefits of that plan may not be achieved at the time or to the extent expected, or at all.	The value of the Syndicate decreases, resulting in a lack of ACGL Group confidence.	The Syndicate's strategic ambitions include management of strategic risk in accordance with the ACGL Group premium and profitability plans and targets. We do this through: • Constant monitoring and management of agreed strategic targets; • Monitoring of cost savings to ensure they remain on track; and • Monitoring and reporting of capital levels.
Underwriting and pricing risk We are subject to the risk that inappropriate business could be written (or not specifically excluded) and inappropriate prices charged. This includes catastrophe risk arising from losses due to unpredictable natural and man-made events affecting multiple covered risks.	Adverse loss experience impacting current year and future year business performance.	The Syndicate's insurance risk strategy is to maintain an acceptable level of underwriting exposure within preferred business lines, across a diverse range of distribution channels, products and geographies. We do this through: • Underwriting guidelines for all business transacted, restricting the types and classes of business that may be accepted; • Exception reports and underwriting monitoring tools; • Internal quality assurance programmes; • Pricing policies by product line; • Analysis of comprehensive data to refine pricing; • Purchase of reinsurance to limit exposures; and • Analysis of all property portfolios to determine expected maximum losses.
Reserving risk Due to the uncertain nature and timing of the risks to which we are exposed, we cannot precisely determine the amounts that we will ultimately pay to meet the liabilities covered by the insurance policies written.	Adverse development in prior year reserves resulting in significant deviations in earnings.	The Syndicate's Reserve risk strategy is to book reserves being adequate compared to the independent actuaries' estimate. Technical reserves are estimated by: • A range of actuarial and statistical techniques, with projections of ultimate claims cost involving assumptions across a range of variables, including estimates of trends in claims frequency and average claim amounts based on facts and circumstances at a given point in time; • Making assumptions on other variable factors, including the legal, social, economic and regulatory environments. Other factors considered include business mix, consumer behaviour, market trends, underwriting assumptions, risk pricing models, inflation in medical care costs, future earnings inflation and other relevant forms of inflation, the performance and operation of reinsurance assets and future investment returns; • Stress and scenario testing; and • Management's estimate of reserves being adequate compared to the independent actuaries' estimate.

Strategic Report *(continued)*

Principal risks and uncertainties *(continued)*

Principal risks	Impact	Strategy, management and mitigation
Ceded reinsurance risk The risk to the Syndicate arises where reinsurance contracts put in place to reduce gross insurance risk do not perform as anticipated.	Adverse impact on the financial results.	The Syndicate's reinsurance programmes are determined from the underwriting team business plans and seek to protect Syndicate capital from an adverse volume or volatility of claims on both per risk and per event basis. • The Syndicate aims to establish appropriate retention levels and limits of protection that are consistent with keeping within the Board's risk tolerance and achieving the target rates of return; • Provide stable, sustainable core capacity for each product line with non-core reinsurance purchased when market conditions allow; • ACGL security guidelines are in place to ensure that we deal with a panel of trusted reinsurers; and • The Syndicate also benefits from an internal quota share with Arch Reinsurance Ltd., the level of which is set at 15%.
Operational risk The risks of direct or indirect losses resulting from inadequate or failed internal processes, fraudulent claims or from systems and people, or from external events including changes in the competitor, regulatory or legislative environments.	Adverse events with potential financial, reputational, legal and customer impacts.	The Syndicate recognises that certain operational risks are unavoidable and seeks to limit exposure to operational risks through ensuring that an effective infrastructure, robust systems and controls and appropriately experienced and qualified individuals are in place throughout the organisation. • We have enhanced many of our operational processes. This includes enhancing our Risk Management framework to integrate risk, business and capital strategies; • We maintain a robust internal control environment; • We maintain a robust risk capture, management and reporting system; and • We recognise the value of our human resources and have appropriate HR policies to develop and retain our staff.
Investment risk *Market risk* – the risk of adverse financial impact due to changes in fair values of future cash flows of instruments held in the investment portfolio as a result of changes in interest rates, credit spread and foreign exchange rates. *Credit risk* – the risk of exposure if another party fails to perform its financial obligations, including failing to perform them in a timely manner. *Liquidity risk* – the risk of maintaining insufficient financial resources to meet business obligations as and when they fall due.	Adverse movements due to asset value reduction, mismatch in assets and liabilities, and default of third parties. Inability to meet cash flows under stress.	The Syndicate's investment strategy is to protect the value of capital, focusing on assets that we consider are capable of producing a consistent and recurring flow of income over time. The Syndicate's liquidity management ensures that a minimum percentage of consolidated investments are held in liquid, short term money market securities, to ensure that there are sufficient liquid funds available to meet obligations to policyholders and other creditors as they fall due. Our investment portfolio is managed and controlled through: • Investment strategy and guidelines proposed to the Board by the Investment Committee and monitored by the Investment Committee; • Diverse holding of types of assets including geographies, sectors and credit ratings; and • Stress testing and scenario analysis.
Counterparty credit risk We partner with many suppliers and the failure of any of these to perform their financial obligations or perform them in a timely manner could result in a financial loss. The principal area of counterparty risk is our use of inter-company quota share reinsurance as a capital management tool.	Loss due to default of banks, reinsurers, brokers or other third parties.	The Syndicate's strategy is to avoid risk of large losses from counterparty failures through prudent counterparty selection and review of credit exposures. • Credit limits are set for all significant counterparties, including reinsurers; • Requirement for minimum credit ratings for reinsurers; • Broker credit exposures are monitored by the business; and • There is a trust fund for the inter-company quota share.

Strategic Report *(continued)*

Principal risks and uncertainties *(continued)*

Principal risks	Impact	Strategy, management and mitigation
Regulatory risk Changes in law and regulations are not identified, understood, or are inappropriately and incorrectly interpreted, or adopted, or business practices are not efficiently modified. Further, there is a risk that current legal or regulatory requirements are not complied with.	Customer impact, financial loss and regulatory censure. Regulatory sanction, legal action or revenue loss.	The Syndicate's Regulatory risk strategy is to comply with all laws and regulations. • We have a constructive and open relationship with our regulators; and • We continue to monitor all regulatory changes as and when they are required by our regulators.
Conduct risk The risk of failing to deliver the appropriate treatment for our customers throughout all stages of the customer journey and that our people fail to behave with integrity.	Potential customer detriment, financial loss and regulatory censure and sanction.	The Syndicate's conduct risk strategy is to ensure good customer outcomes. • Our organisational culture prioritises a consistent approach towards customers and the interests of customers are at the heart of how we operate; and • We have developed a robust customer conduct risk management framework to minimise our exposure to conduct risk.
Group and reputational risk We are dependent on the strength of our Group, our reputation with customers and distributors in the sale of products and services. We have entered into various strategic partnerships that are important to the marketing, sale and distribution of our products.	Loss of Group value negatively impacts our ability to retain and write new business.	The Syndicate derives benefits from being part of the ACGL Group and use of the Lloyd's Franchise. Group risk is primarily managed at the executive level, through building strong relationships with all parties. The Syndicate's reputational risk strategy is to protect our brand and reputation. We do this through: • Regularly reviewing our brand and reputational risk exposure by various governance committees; and • Seeking to offer a superior service to customers and to treat customers fairly in line with Financial Conduct Authority ("FCA") principles.

Outlook and Future Developments

Our business faced some challenging rating and economic conditions during 2018, which impacted both our underwriting and investment returns. However, we enter 2019 with some optimism with firmer pricing for some lines of business and higher interest rates to underpin our investment returns. There remains a high level of uncertainty with political risk threatening global growth through trade wars and protectionism.

This environment means the Syndicate must be nimble and flexible, showing a willingness to innovate in terms of distribution and new markets while maintaining underwriting discipline. Our objective is to achieve an average operating return on average equity of 12% or greater over the insurance cycle, which we believe to be an attractive return to our ordinary shareholders, given the risks we assume. The Syndicate has tried and tested governance and underwriting controls and there remains a strong emphasis on risk selection and price adequacy.

The Syndicate non-renewed the Australia and New Zealand travel binder which was due for renewal on the 1 December 2018. We continue to look for opportunities to find acceptable books of business to underwrite without sacrificing underwriting discipline.

Strategic Report *(continued)*

Outlook and Future Developments *(continued)*

Brexit

Brexit has continued to be a source of considerable uncertainty over 2018, and our Brexit plans have been based on the scenario that UK insurance companies will not be permitted to conduct insurance business in the European Economic Area (EEA).

Our plans as broadly summarised as follows:

- Arch Insurance (EU) DAC (AIEU) is domiciled in Ireland and is authorised by the Irish regulator, the Central Bank of Ireland (CBI).
- AIEU has extended its authorisations to cover the appropriate classes of insurance relating to EEA business previously written on UK Company paper. This application was approved by the CBI in February 2019.
- AIEU will provide cover on and from 29 March 2019 for all EEA policies.
- EEA business written on the Lloyd's platform is being placed using the Lloyd's Insurance Company in Brussels from 1 January 2019.
- For all valid claims on policies incepting before 29 March 2019, Arch will apply all legal means and options to ensure that we are able to service our contracts and to pay claims.

The plans set out above will ensure that we retain passporting rights with Europe following the UK's withdrawal.

Approved by the Board and signed on behalf of the Board by:

Pasquale Leoni
Director
Arch Underwriting at Lloyd's Ltd
21 March 2019

Report of the Managing Agent

Ownership

The ultimate parent company of Arch Syndicate Investments Ltd is Arch Capital Group Ltd ("ACGL"), a Bermuda-based company with $11.2bn (2017: $11.3bn) of shareholder capital as at 31 December 2018. Through operations in Bermuda, the United States of America, Europe, Canada, and Australia, ACGL writes insurance and reinsurance on a worldwide basis. ACGL is listed on the Nasdaq U.S. stock market.

Directors

The Directors of the Managing Agent who held office during the year were as follows:

S. Bashford	Chief Underwriting Officer	
P-A. Camps	Non-Executive	(Resigned 15 November 2018)
N. Denniston	Non-Executive and Chairman	
J. Kittinger	Finance Director	
P. Leoni	Chief Underwriting Officer	
P. Mailloux	Non-Executive	(Resigned 15 December 2018)
P. Martin	Non-Executive	
D. McElroy	Non-Executive	(Resigned 2 August 2018)
M. Shulman	President and Chief Executive Officer	
B. Singh	Chief Risk Officer	(Resigned 8 February 2018)
P. Storey	Non-Executive	

Donations

The Syndicate made no political or charitable contributions during the year (2017: £nil).

Financial Risk Management

Please refer to Note 3C to Note 3G to the financial statements on pages 24-30.

Dividend

The Directors do not propose a dividend for the year (2017: £nil).

Business Review

Please refer to Strategic Report on pages 1-2.

Employee information

Please refer to Corporate and Social Responsibility in the Strategic Report on page 3.

Outlook and Future Developments

Please refer to Strategic Report on page 7-8.

The Directors are covered by qualifying third party indemnity policies.

Report of the Managing Agent *(continued)*

Statement of Managing Agent Responsibilities

The Directors are responsible for preparing the Syndicate annual report and annual accounts in accordance with applicable law and regulations, including the Financial Reporting Standard 102 The Financial Reporting Standard Applicable in the UK and Republic of Ireland ("FRS 102"), and Financial Reporting Standard 103 Insurance Contracts ("FRS 103").

In accordance with the Insurance Accounts Directive (Lloyd's Syndicate and Aggregate Accounts) Regulations 2008, managing agents are required to prepare Syndicate annual accounts for each financial year which give a true and fair view of the state of affairs of the Syndicate and of its profit or loss for that year.

In preparing the Syndicate annual accounts, the Managing Agent is required to:

- Select suitable accounting policies and then apply them consistently;
- Make judgements and estimates that are reasonable and prudent;
- State whether applicable UK accounting standards, including FRSs 102 and 103 have been followed, subject to any material departures disclosed and explained in the annual accounts; and
- Prepare the annual accounts on the basis that the Syndicate will continue to write future business, unless it is inappropriate to presume that the Syndicate will do so.

The Managing Agent confirms it has complied with the above requirements in preparing the annual accounts.

The Managing Agent is responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Syndicate and enable it to ensure that the Syndicate annual accounts comply with the 2008 Regulations. It is also responsible for safeguarding the assets of the Syndicate and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Statement of Disclosure of Information to Auditors

Each of the persons who are Directors of the Managing Agent at the date of approval of this report confirms that:

- So far as the Directors are aware, there is no information relevant to the audit of the Syndicate's annual accounts for the year ended 31 December 2018 of which the auditors are unaware; and
- The Directors have taken all the steps that they ought to have taken in their duty as Directors of the Managing Agent in order to make themselves aware of any relevant audit information and to establish that the Syndicate's auditors are aware of that information.

Report of the Managing Agent *(continued)*

Statement of Managing Agent Responsibilities *(continued)*

Independent Auditors

The independent auditors, PricewaterhouseCoopers LLP, have indicated their willingness to continue in office and they will be re-appointed by the Directors of the Managing Agent for the forthcoming year.

Approved by the Board and signed on behalf of the Board by:

Pasquale Leoni
Director
Arch Underwriting at Lloyd's Ltd
21 March 2019

Independent Auditors' Report to the Members of Syndicate 2012

Report on the syndicate annual accounts

Opinion

In our opinion, Syndicate 2012's syndicate annual accounts (the "syndicate annual accounts"):

- give a true and fair view of the state of the syndicate's affairs as at 31 December 2018 and of its loss and cash flows for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice, (United Kingdom Accounting Standards comprising FRS 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland); and
- have been prepared in accordance with the requirements of The Insurance Accounts Directive (Lloyd's Syndicate and Aggregate Accounts) Regulations 2008.

We have audited the syndicate annual accounts included within the Annual Report and Accounts (the "Annual Report"), which comprise: the balance sheet as at 31 December 2018, the profit and loss account for the year then ended, the statement of comprehensive income for the year then ended, the statement of changes in member's balance, the statement of cash flows, and the notes to the syndicate annual accounts, which include a summary of significant accounting policies and other explanatory information.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and The Insurance Accounts Directive (Lloyd's Syndicate and Aggregate Accounts) Regulations 2008, as amended by The Statutory Auditors and Third Country Auditors Regulations 2017 and other applicable law.

Our responsibilities under ISAs (UK) are further described in the Auditors' responsibilities for the audit of the syndicate annual accounts section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

We remained independent of the syndicate in accordance with the ethical requirements that are relevant to our audit of the syndicate annual accounts in the UK, which includes the FRC's Ethical Standard, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

Conclusions relating to going concern

ISAs (UK) require us to report to you when:

- the managing agent's use of the going concern basis of accounting in the preparation of the syndicate annual accounts is not appropriate; or
- the managing agent has not disclosed in the syndicate annual accounts any identified material uncertainties that may cast significant doubt about the syndicate's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the syndicate annual accounts are authorised for issue.

We have nothing to report in respect of the above matters.

However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the syndicate's ability to continue as a going concern. For example, the terms on which the United Kingdom may withdraw from the European Union are not clear, and it is difficult to evaluate all of the potential implications on the syndicate's business and the wider economy.

Independent Auditors' Report to the Members of Syndicate 2012 *(continued)*

Reporting on other information
The other information comprises all of the information in the Annual Report other than the syndicate annual accounts and our auditors' report thereon. The managing agent is responsible for the other information. Our opinion on the syndicate annual accounts does not cover the other information and, accordingly, we do not express an audit opinion or, except to the extent otherwise explicitly stated in this report, any form of assurance thereon.

In connection with our audit of the syndicate annual accounts, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the syndicate annual accounts or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If we identify an apparent material inconsistency or material misstatement, we are required to perform procedures to conclude whether there is a material misstatement of the syndicate annual accounts or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report based on these responsibilities.

With respect to the Managing Agent's Report, we also considered whether the disclosures required by Insurance Accounts Directive (Lloyd's Syndicate and Aggregate Accounts) Regulations 2008 have been included.

Based on the responsibilities described above and our work undertaken in the course of the audit, ISAs (UK) require us also to report certain opinions and matters as described below.

Managing Agent's Report
In our opinion, based on the work undertaken in the course of the audit, the information given in the Managing Agent's Report for the year ended 31 December 2018 is consistent with the syndicate annual accounts and has been prepared in accordance with The Insurance Accounts Directive (Lloyd's Syndicate and Aggregate Accounts) Regulations 2008.

In light of the knowledge and understanding of the syndicate and its environment obtained in the course of the audit, we did not identify any material misstatements in the Managing Agent's Report.

Responsibilities for the syndicate annual accounts and the audit

Responsibilities of the managing agent for the syndicate annual accounts
As explained more fully in the Statement of Managing Agent's Responsibilities set out on pages 10-11, the managing agent is responsible for the preparation of the syndicate annual accounts in accordance with the applicable framework and for being satisfied that they give a true and fair view. The managing agent is also responsible for such internal control as they determine is necessary to enable the preparation of syndicate annual accounts that are free from material misstatement, whether due to fraud or error.

In preparing the syndicate annual accounts, the managing agent is responsible for assessing the syndicate's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless it is intended for the syndicate to cease operations, or it has no realistic alternative but to do so.

Auditors' responsibilities for the audit of the syndicate annual accounts
Our objectives are to obtain reasonable assurance about whether the syndicate annual accounts as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these syndicate annual accounts.

A further description of our responsibilities for the audit of the syndicate annual accounts is located on the FRC's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditors' report.

Independent Auditors' Report to the Members of Syndicate 2012 *(continued)*

Use of this report

This report, including the opinions, has been prepared for and only for the syndicate's members as a body in accordance with part 2 of The Insurance Accounts Directive (Lloyd's Syndicate and Aggregate Accounts) Regulations 2008, as amended by The Statutory Auditors and Third Country Auditors Regulations 2017 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Other required reporting

Other matters on which we are required to report by exception

Under The Insurance Accounts Directive (Lloyd's Syndicate and Aggregate Accounts) Regulations 2008, as amended by The Statutory Auditors and Third Country Auditors Regulations 2017, we are required to report to you if, in our opinion:

- we have not received all the information and explanations we require for our audit; or
- the managing agent in respect of the syndicate has not kept adequate accounting records; or
- certain disclosures of managing agent remuneration specified by law are not made; or
- the syndicate annual accounts are not in agreement with the accounting records.

We have no exceptions to report arising from this responsibility.

Kirstie Hanley

Kirstie Hanley (Senior statutory auditor)
For and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London
22 March 2019

Profit and Loss Account: Technical Account – General Business
For the year ended 31 December 2018

	Notes	2018 £000	2017 Restated £000
Earned premium, net of reinsurance			
Gross premiums written		232,004	199,896
Outward reinsurance premiums	*5*	(61,939)	(53,478)
Net premiums written		170,065	146,418
Change in the gross provision for unearned premiums		(2,404)	5,105
Change in the provision for unearned premiums, reinsurers' share		2,642	(70)
Earned premiums, net of reinsurance		170,303	151,453
Allocated investment return transferred from the non-technical account		169	(243)
Total technical income		**170,472**	**151,210**
Claims incurred, net of reinsurance			
Claims paid			
-gross amount		(117,853)	(113,692)
-reinsurers' share		24,115	22,065
	13	(93,738)	(91,627)
Change in the provision for claims			
-gross amount		(11,052)	(27,266)
-reinsurers' share		7,784	11,841
		(3,268)	(15,425)
Claims incurred, net of reinsurance	13	(97,006)	(107,052)
Net operating expenses	*6*	(69,315)	(68,775)
Total technical charges		**(166,321)**	**(175,827)**
Balance on the technical account for general business		**4,151**	**(24,617)**

All Operations are continuing.

The notes on pages 19 to 45 form part of these financial statements.

Profit and Loss Account: Non-Technical
For the year ended 31 December 2018

	Notes	2018 £000	2017 £000
Balance on the general business technical account		4,151	(24,617)
Investment income		3,094	3,571
Gains on the realisation of investments		149	720
Investment expenses and charges		(69)	(1,214)
Losses on the realisation of investments		(1,018)	(1,050)
Unrealised losses on investments		(80)	(1,723)
	7	2,076	304
Allocated investment return transferred to the general business technical account		(169)	243
Non-technical loss on exchange		(6,918)	(2,810)
Total loss for the year		**(860)**	**(26,880)**

Statement of Comprehensive Income
For the year ended 31 December 2018

	2018 £000	2017 £000
Loss for the year	(860)	(26,880)
Other comprehensive income	-	-
Other comprehensive income for the year	-	-
Total comprehensive income for the year	**(860)**	**(26,880)**

All results are attributable to continuing operations.

There is no material difference between the loss for the financial year as stated above and the historical cost equivalents.

The notes on pages 19 to 45 form part of these financial statements.

Balance Sheet
As at 31 December 2018

	Notes	2018 £000	2017 £000
ASSETS			
Financial Investments			
Shares and other variable yield securities	*12*	35,185	45,345
Debt securities and other fixed income securities	*12*	165,643	138,223
		200,828	183,568
Reinsurers' share of technical provisions			
Provision for unearned premiums	*13*	22,603	19,491
Claims outstanding		92,938	83,431
	13	115,541	102,922
Debtors			
Debtors arising out of direct insurance operations		53,044	52,305
Debtors arising out of direct reinsurance operations		5,647	1,320
Other debtors	*9*	16,704	12,690
		75,395	66,315
Other assets			
Cash at bank and in hand		12,766	16,389
Overseas deposits	*12*	72,226	65,750
Other assets	*10*	7,722	6,244
		92,714	88,383
Prepayments and accrued income			
Deferred acquisition costs		20,035	20,409
Other prepayments and accrued income		1,439	1,360
TOTAL ASSETS		**505,952**	**462,957**
LIABILITIES			
Capital and reserves			
Member's balance		80,188	55,548
Technical provisions			
Provision for unearned premiums	*13*	78,863	74,724
Claims outstanding		310,931	296,828
	13	389,794	371,552
Creditors			
Creditors arising out of reinsurance operations		23,348	11,438
Other creditors	*9*	6,073	18,404
		29,421	29,842
Accruals and deferred income	*11*	6,549	6,015
TOTAL LIABILITIES		**505,952**	**462,957**

The notes on pages 19 to 45 form part of these financial statements

The financial statements on pages 15 to 17 were approved by the Board of Arch Underwriting at Lloyd's Ltd on 21 March 2019 and were signed on their behalf by:

Jason Kittinger
Finance Director
Arch Underwriting at Lloyd's Ltd
21 March 2019

Statement of Changes in Members Balance

As at 31 December 2018

	2018 £000	2017 £000
Brought forward at 1 January 2018	55,548	82,428
Loss for the financial year	(860)	(26,880)
Capital Contribution	25,500	-
Member's balances carried forward at 31 December 2018	**80,188**	**55,548**

The notes on pages 19 to 45 are an integral part of these financial statements.

Statement of Cash Flows

For the year ended 31 December 2018

Reconciliation of operating profit / (loss) to net cash inflow from operating activities	**2018** **£000**	**2017** **Restated** **£000**
Operating (loss) on ordinary activities	(860)	(26,880)
Increase in gross technical provisions	14,662	31,359
(Increase) in reinsurers' share of gross technical provisions	(11,627)	(11,363)
(Increase) / decrease in debtors	(9,488)	20,155
(Decrease) / increase in creditors	(337)	1,732
(Increase) in other assets / liabilities	(9,022)	(14,340)
Investment return	(2,076)	(304)
Change in market value and currency	4,847	3,540
Foreign exchange on cash and cash equivalents	164	(123)
Net cash (outflow) / inflow from operating activities	**(13,737)**	**3,766**
Purchase of equity and debt instruments	(242,492)	(230,912)
Sale of equity and debt instruments	224,014	227,957
Investment income received	3,092	-
Net cash outflow from investing activities	**(15,387)**	**(2,955)**
Capital contribution	25,500	-
Cash flows from financial activities	**25,500**	-
Net (decrease) / increase in cash and cash equivalents	(3,623)	821
Cash at bank and in hand at beginning of year	16,389	15,568
Cash at bank and in hand at end of year	12,766	16,389

The notes on pages 19 to 45 form part of these financial statements.

Notes to the Financial Statements

1 General Information

The Syndicate transacts in the underwriting of general insurance business at Lloyd's with underwriting capacity being provided by Arch Syndicate Investments Ltd. The address of the Managing Agent's registered office is 5th Floor, Plantation Place South, 60 Great Tower Street, London, EC3R 5AZ.

2 Basis of Preparation

(a) Statement of compliance

The financial statements of the Syndicate have been prepared in compliance with United Kingdom Accounting Standards, including Financial Reporting Standard 102, "The Financial Reporting Standard applicable in the United Kingdom and the Republic of Ireland" ("FRS 102"), Financial Reporting Standard 103, "Insurance Contracts" (FRS 103) and the Companies Act 2006. The Syndicate financial statements have been prepared in compliance with the provisions of the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations relating to insurance groups.

(b) Basis of measurement

The preparation of financial statements in conformity with FRS 102 requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Syndicate's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the financial statements are disclosed in Note 2e.

(c) Going Concern

The Directors have an expectation that the Syndicate has adequate resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the financial statements.

(d) Functional and presentation currency

These financial statements are presented in pounds sterling (pounds), which is the functional currency of the Syndicate, and are rounded to the nearest thousand unless otherwise stated.

(e) Use of estimates and judgements

The preparation of the financial statements in conformity with the Generally Accepted Accounting Practice in the UK ("UK GAAP"), requires management to make judgements, estimates and assumptions that affect the application of accounting policies and reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected.

These disclosures supplement the commentary on insurance and financial risk management in the Strategic Report.

Key sources of estimation uncertainty

The areas of the Syndicate's business containing key sources of estimation uncertainty include the measurement of insurance and reinsurance assets and liabilities at the balance sheet date. The most significant of these involves the valuation of outstanding claims and, in particular, the provision for claims incurred but not reported.

The processes used to determine the assumptions on which the measurement of insurance contract provisions is based, actual assumptions used, the effects of changes in assumptions, and an analysis of sensitivity to changes in assumptions are described below.

Notes to the Financial Statements *(continued)*

2 Basis of Preparation *(continued)*

(e) Use of estimates and judgements *(continued)*

Process used to determine the assumptions for measuring insurance contracts

Loss Reserves for the Syndicate are comprised of (1) estimated amounts for claims reported ("case reserves") and (2) incurred but not reported ("IBNR") losses. Claims personnel determine whether to establish a case reserve for the estimated amount of the ultimate settlement of individual claims. The estimate reflects the judgement of claims personnel based on general corporate reserving practices, the experience and knowledge of such personnel regarding the nature and value of the specific type of claim and, where appropriate, advice of counsel. The Syndicate also contracts with a number of outside third-party administrators in the claims process who, in certain cases, have limited authority to establish case reserves. The work of such administrators is reviewed and monitored by our claims personnel.

Loss Reserves are also established to provide for loss adjustment expenses and represent the estimated expense of settling claims, including legal and other fees and the general expenses of administering the claims adjustment process. Periodically, adjustments to the reported or case reserves may be made as additional information regarding the claims is reported or payments are made. IBNR reserves are established to provide for incurred claims which have not yet been reported to an insurer or reinsurer at the balance sheet date, as well as to adjust for any projected variance in case reserving. IBNR reserves are derived by subtracting paid losses and loss adjustment expenses and case reserves from estimates of ultimate losses and loss adjustment expenses. Actuaries estimate ultimate losses and loss adjustment expenses using various generally accepted actuarial methods applied to known losses and other relevant information. Like case reserves, IBNR reserves are adjusted as additional information becomes known or payments are made. The process of estimating reserves involves a considerable degree of judgement by management and, as of any given date, is inherently uncertain.

Ultimate losses and loss adjustment expenses are generally determined by extrapolation of claim emergence and settlement patterns observed in the past that can reasonably be expected to persist into the future. The Syndicate uses several methods for determining its reserves. These methods generally fall into one of the following categories or are hybrids of one or more of the following categories:

Expected loss methods – these methods are based on the assumption that ultimate losses vary proportionately with premiums. Expected loss and loss adjustment expense ratios are typically developed based upon the information derived by underwriters and actuaries during the initial pricing of the business, supplemented by industry data available from organisations, such as statistical bureau and consulting firms, where appropriate. These ratios consider, among other things, rate increases and changes in terms and conditions that have been observed in the market. Expected loss methods are useful for estimating ultimate losses and loss adjustment expenses in the early years of long-tailed lines of business, when little or no paid or incurred loss information is available, and is commonly applied when limited loss experience exists for a syndicate.

Historical incurred loss development methods – these methods assume that the ratio of losses in one period to losses in an earlier period will remain constant in the future. These methods use incurred losses (i.e. the sum of cumulative historical loss payments plus outstanding case reserves) over discrete periods of time to estimate future losses. Historical incurred loss development methods may be preferable to historical paid loss development methods because they explicitly take into account open cases and the claims adjusters' evaluations of the cost to settle all known claims. However, historical incurred loss development methods necessarily assume that case reserving practices are consistently applied over time. Therefore, when there have been significant changes in how case reserves are established, using incurred loss data to project ultimate losses may be less reliable than other methods.

Bornhuetter-Ferguson ("B-F") paid and incurred loss methods – these methods utilise actual paid and incurred losses and expected patterns of paid and incurred losses, taking the initial expected ultimate losses into account to determine an estimate of expected ultimate losses. The B-F paid and incurred loss methods are useful when there are few reported claims and a relatively less stable pattern of reported losses.

Notes to the Financial Statements *(continued)*

2 Basis of Preparation *(continued)*

(e) Use of estimates and judgements *(continued)*

Additional analyses – other methodologies are often used in the reserving process for specific types of claims or events, such as catastrophic or other specific major events. These include vendor catastrophe models, which are typically used in the estimation of Loss Reserves at the early stage of known catastrophic events before information has been reported to an insurer or reinsurer, and analyses of specific industry events, such as large lawsuits or claims.

3 Management of Risk

The Syndicate's core business is to take risk and our mission is to generate a positive contribution to the growth in the Tangible Book Value (TBV) of our ultimate parent company, ACGL. We do this through our objective of maximising return on equity within a defined 'risk appetite'. It is therefore essential that we understand the significant exposures we face to manage the business well. It is also important that our knowledge of those risks underpins every important decision we make across the Syndicate. The risks from our core business of insurance represent our most significant exposures.

A – Strategic Risk

This is the risk that the Syndicate's strategy is inappropriate or that the Syndicate is unable to implement its strategy. Where events supersede the Syndicate's strategic plan this is escalated at the earliest opportunity through the Syndicate's monitoring tools and governance structure. On a day-to-day basis, the Syndicate's management structure encourages organisational flexibility and adaptability, while ensuring that activities are appropriately coordinated and controlled. Staff, management and outsourced service providers are expected to excel in service and quality. Individuals and teams are also expected to transact their activities in an open and transparent way. These behavioural expectations reaffirm our low risk tolerance by aligning interests of all stakeholders.

B – Insurance Risk

(i) Underwriting Risk

The process of selecting and pricing insurance risks is addressed through a framework of policies, procedures and internal controls. Risk selection is our business and our procedures are designed to ensure that the evaluation of risk is transparent and logical. We have a clearly defined appetite for underwriting risk, which dictates our business plan.

To ensure that our risk appetite is not exceeded, we maintain disciplined underwriting, regularly monitor closely our exposures to and aggregations of risk in particular places, and buy reinsurance to limit our losses from disasters. We adapt our business plan, target products and reinsurance programme to ensure our book of business is well diversified. The Syndicate's long-term underwriting strategy is to seek a diverse and balanced portfolio of risks in order to limit volatility. This is achieved by accepting a spread of business over time, segmented between different classes of business and geography.

The quality of our underwriting models and our capability to accurately measure our aggregate exposure are key to managing this risk. Our underwriters are given incentives to make sound decisions that are aligned with the Syndicate's overall strategic objectives and risk appetite. Clear limits are also placed on their authority. We regularly review our policy wordings in the light of legal developments to ensure the Syndicate's exposure is restricted, as far as possible, to those risks identified in the policy at the time it was issued.

The Syndicate has large aggregate exposures to natural and man-made catastrophic events. These risks are inherently uncertain as it is difficult to predict the timing of such events with statistical certainty or estimate the amount of loss which any given occurrence will generate. The Syndicate regularly monitors its exposure to catastrophic events, including earthquake, wind and terrorism, using a catastrophe modelling tool, ("AIR") (Property, Terrorism and Onshore Energy), both locally and at Arch Group level. Catastrophe modelling was previously carried out using RMS, and this was transitioned to AIR over 2018. Additionally, the Syndicate regularly monitors its exposure to man-made realistic disaster scenarios.

Notes to the Financial Statements *(continued)*

3 Management of Risk *(continued)*

B – Insurance Risk *(continued)*

(i) Underwriting Risk *(continued)*

The Syndicate seeks to limit its loss exposure by purchasing reinsurance to limit exposure to certain extreme events. The Syndicate monitors concentration risk through limiting its loss exposure by geographical and line of business diversification. (See note 5 for supporting tables).

The Syndicate's largest exposures to natural catastrophe 1 in 250 year stress events, gross and net basis at December 2018 are:

Territory	Peril	Gross £m	Net £m
Caribbean	Windstorm	80.4	47.4
Australia	Earthquake	21.4	10.0
Canada	Earthquake	19.5	10.1
Caribbean	Earthquake	18.4	10.1
New Zealand	Earthquake	17.7	9.4
Japan	Earthquake	17.0	9.7
Mexico	Windstorm	15.4	10.0
United States	Earthquake	14.1	10.4
South America	Earthquake	11.8	6.7
Europe	Earthquake	7.2	5.8

In common with all insurers, the Syndicate is exposed to price volatility. However, the Syndicate is firm in its resolve to reject business that is unlikely to generate underwriting profit. Additionally, the Syndicate alters its appetite for the lines of business and the layers it writes within them in response to market conditions.

The Syndicate writes a significant amount of premium income through coverholder arrangements to whom binding authority is given to accept risks on behalf of the Syndicate. This delegation is strictly controlled through tight underwriting guidelines and limits, and extensive monitoring, review and audits.

Notes to the Financial Statements *(continued)*

3 Management of Risk *(continued)*

B – Insurance Risk *(continued)*

(ii) Reserving and Claims Risk

The Syndicate's claims teams are focused upon delivering quality, reliability and speed of service to both internal and external clients. Their aim is to adjust and process claims in a fair, efficient and timely manner, in accordance with the policy's terms and conditions, the regulatory environment, and the Syndicate's broader interests. Our objective is to set prompt and accurate case reserves for all known claims liabilities, including provisions for expenses.

The Syndicate operates to a prudent best estimate reserving philosophy. Reserve estimates are derived by the internal actuary after consultation with individual underwriters, claims team, actuarial analysis of the loss reserve development and comparison with market benchmarks. The objective is to produce reliable and appropriate estimates that are consistent over time and across classes of business. The internal actuary's loss assessments are peer reviewed by ACGL actuaries, and the reserves also are subject to review by external actuaries. Generally, reserves are established without regard to whether the claim may be subsequently contested, and reserves are not discounted for the time value of money.

The following table shows the impact of an increase or reduction in claims handling expense and number of IBNR claims, on the profit or loss account.

	Claims inflation assumption £000		**Claims handling expenses £000**		**Number of IBNR claims £000**	
	+5% increase	**-5% reduction**	**+10% increase**	**-10% reduction**	**+5% increase**	**-5% reduction**
2018 Impact on profit after tax and equity						
Gross of Reinsurance	(16,424)	16,424	(309)	309	(8,628)	8,628
Net of Reinsurance	(11,797)	11,797	(309)	309	(6,052)	6,052
2017 Impact on profit after tax and equity						
Gross of Reinsurance	(15,740)	15,740	(412)	412	(9,062)	9,062
Net of Reinsurance	(11,569)	11,569	(412)	412	(6,456)	6,456

(iii) Ceded Reinsurance Risk

Reinsurance risk to the Syndicate arises where reinsurance contracts put in place to reduce gross insurance risk do not perform as anticipated, resulting in coverage disputes or prove inadequate in terms of the vertical or horizontal limits purchased. The Syndicate's reinsurance programmes are determined from the underwriting team business plans and seek to protect Syndicate capital from an adverse volume or volatility of claims on both as per risk and per event basis. In 2018, the Syndicate bought a combination of proportional and non-proportional reinsurance treaties and facultative reinsurance to reduce the maximum net exposure. The Syndicate aims to establish appropriate retention levels and limits of protection that are consistent with keeping within the Board's risk tolerance and achieving the target rates of return. The efficacy of protection sought is assessed against the cost of reinsurance, taking into consideration current and expected market conditions.

Notes to the Financial Statements *(continued)*

3 Management of Risk *(continued)*

(iii) Ceded Reinsurance Risk *(continued)*

The Syndicate's reinsurance philosophy is to:

- Provide stable, sustainable core capacity for each product line with non-core reinsurance purchased when market conditions allow;
- Reduce volatility;
- Achieve a broad spread of well rated security;
- Purchase reinsurance to limit exposure from maximum line sizes and accumulations with Catastrophe limits purchased up to our risk appetite;
- Utilise AIR as the standard model throughout ACGL;
- Comply with the guidance from the ACGL Security Committees;
- Apply common standards throughout ACGL;
- Consider hard and soft factors such as ability to pay and willingness to pay;
- Set cession limits by reinsurer and by lines of business; and
- Strive for 100% of security rated A- or higher at the time of purchase.

The Syndicate also benefits from an internal quota share with Arch Reinsurance Ltd., the level of which is set at 15.0% of premiums and claims.

C – Operational Risk

Management continually review potential operational risk factors and has enacted controls to meet these. They have been classified as follows:

Operational Risk Classification	Description
People	Loss of staff (underwriting and key non-underwriting) or inability to recruit; issues concerning integrity and competence of staff, including training; succession; manual inputting error; lack of management supervision and or failure of escalation to management; and data protection breach or loss.
Processes	Inappropriate underwriting; inappropriate claims and reserve handling; inappropriate reinsurance purchasing; failure of a third-party supplier; inadequate segregation of duties; inadequate management information; weak processing controls; and failure of corporate governance.
Systems (including Cyber Attack)	Hardware/software failure; network telecommunications software; IT third-party provider failure; inadequate virus protection; inadequate system or security information; insufficient or untested business continuity processes; insufficient processing capacity; and systems error.
External events, including physical security and business continuity	Natural or man-made disasters leading to business continuity threat; external financial crime, including theft or fraud; changes to the regulatory environment; external security breach; and power outage.
Outsourcing, including delegated underwriting	Failure of an outsourced service provider, including breach of agreement.
Financial crime, including Anti-Money Laundering	Internal or external fraud and or financial crime.
Legal	Risk of loss resulting from failure to comply with laws as well as prudent ethical standards and contractual obligations. It also includes the exposure to litigation from all aspects of the Syndicate's activities.

Notes to the Financial Statements *(continued)*

3 Management of Risk *(continued)*

C – Operational Risk *(continued)*

The operational risk profile is reviewed by the Risk Committee and the controls to mitigate the risks are included in the Risk Register. Risk owners are required to report to the Risk Committee and review the relevant risks and are responsible for identifying new, emerging or changing risks and any subsequent control changes required to realign the risks with the risk appetite. When measuring operational risk, both quantitative factors, in the form of the probable loss, and qualitative factors, in the form of an assessment of the likely reputational impact or the ability of the Syndicate to deliver its service, are taken into account and contribute to determining the risk tolerance.

In respect of one of our largest operational risks, failure of an outsourced service provider, we have formal Service Level Agreements and monitoring processes in place for all key outsourced providers including IT service providers and coverholders. We also have a formal disaster recovery plan in place that deals with both workspace recovery and the retrieval of communications, IT systems and data if a major problem occurred. These procedures would enable us to move the affected operations to alternative facilities very quickly. The disaster recovery plan is tested regularly.

Identifying, planning for and controlling emerging risks is an important part of our risk management activity across all aspects of our business, including underwriting, operations and strategy. We make a significant effort to try to identify material emerging threats to the Syndicate. It is a core responsibility of each of our committees and we believe we take all reasonable steps to minimise the likelihood and impact of emerging risks and to prepare for them in case they occur.

D – Market Risks

Our investment results are subject to a variety of risks, including changes in the business, financial condition or results of operations of the entities in which we invest, as well as changes in general economic conditions and overall market conditions. Valuations of investments are also exposed to potential loss from various market risks, including changes in equity prices, interest rates, and exchange rates.

The Syndicate's primary investment objective is to preserve capital and to ensure adequate liquidity for settling policyholder claims, while also providing a return that meets or exceeds the total return of the assigned benchmark for each portfolio. Technical funds, those funds held for reserves, are invested primarily in high quality bonds and cash. The high quality and short duration of these funds allows the Syndicate to meet its aim of paying valid claims quickly. These funds, as far as possible, are maintained in the currency of the original premiums for which they are set aside to reduce foreign exchange risk.

Market risk also encompasses the risk of default of counterparties, which is primarily with issuers of bonds in which we invest. Our third-party investment managers are issued guidelines as to the type and nature of bonds in which to invest.

The value of the Syndicate's fixed income securities is inversely correlated to movements in market interest rates. If market interest rates fall, the fair value of the fixed income investments would tend to rise and vice versa, assuming that credit spreads remain constant.

The sensitivity of the price of a bond is also closely correlated to its duration. The longer the duration of a security, the greater its price volatility.

Notes to the Financial Statements *(continued)*

3 Management of Risk *(continued)*

D – Market Risks *(continued)*

Interest Rate shift in basis Points

Interest rate risk	**2018**	**2017**
	£000	**£000**
Impact of 50 basis point increase on result	(2,482)	(2,098)
Impact of 50 basis point decrease on result	2,220	1,943
Impact of 50 basis point increase on net assets	(2,482)	(2,098)
Impact of 50 basis point decrease on net assets	2,220	1,943

E – Currency Risk

The Syndicate is exposed to currency risk in respect of liabilities under insurance policies and reinsurance recoverable debtors under reinsurance policies, denominated in currencies other than sterling. The most significant currencies to which the Syndicate is exposed are the U.S. Dollar, the Australian Dollar and the Euro.

The Syndicate seeks to mitigate the risk by matching the estimated foreign currency denominated liabilities with assets denominated in the same currency. Assets and liabilities are appropriately matched and as such, the impact to the net result of the Syndicate through movements in the exchange rates between Sterling, USD, AUD and EUR are mitigated. (See note 3G for asset liability matching table).

F – Credit Risk

Exposure to credit risk arises from financial transactions with counterparties including debtors, borrowers, brokers, policyholders, reinsurers and guarantors. The Syndicate uses the credit ratings assigned to particular counterparties to measure credit risk.

To lessen the risk of the Syndicate's exposure to any particular reinsurer, exposure limits are approved. On behalf of the Syndicate, ACGL has developed processes to formally examine all reinsurers before entering into new business arrangements.

The Syndicate has established guidelines for its investment managers regarding the type, duration and quality of investments within the Syndicate guidelines. The performance of investment managers is regularly reviewed to confirm adherence to these guidelines.

Credit distribution of invested assets and cash

	2018	**2018**	**2017**	**2017**
Standard & Poor's	**£m**	**%**	**£m**	**%**
AAA	86.7	30.3	63.7	24.0
AA	115.6	40.5	120.3	45.3
A	54.2	19.0	58.6	22.1
BBB	4.0	1.4	2.7	1.0
BBB or less	3.2	1.1	3.3	1.2
Not rated	22.1	7.7	17.1	6.4
Total	285.8	100.0	265.7	100.0

Notes to the Financial Statements *(continued)*

3 Management of Risk *(continued)*

F – Credit Risk *(continued)*

Credit distribution of reinsurance receivables

A.M. Best	2018 £m	2018 %	2017 £m	2017 %
A++	-	-	0.7	0.8
A+	68.3	73.5	59.5	71.3
A	24.5	26.4	22.1	26.6
A-	-	-	1.0	1.2
NR	0.1	0.1	0.1	0.1
Total	92.9	100.0	83.4	100.0

All recoverable amounts are gross of any internally modelled impairment provision.

Credit Risk – Ageing and Impairment

Financial assets that are past due but not impaired

		Financial assets that are past due but not impaired					
	Neither due nor impaired £000	Up to three months £000	Three to six months £000	Six months to one year £000	Greater than one year £000	Financial assets that have been impaired £000	Total £000
2018							
Shares and other variable yield securities and unit trusts	35,185	-	-	-	-	-	35,185
Debt securities	165,643	-	-	-	-	-	165,643
Overseas deposits as investments	72,226	-	-	-	-	-	72,226
Reinsurers' share of claims outstanding	92,938	-	-	-	-	-	92,938
Reinsurance debtors	5,647	-	-	-	-	-	5,647
Insurance debtors	42,030	7,365	1,237	1,254	1,158	-	53,044
Other debtors	68,503	-	-	-	-	-	68,503
Cash at bank and in hand	12,766	-	-	-	-	-	12,766
Total credit risk	494,938	7,365	1,237	1,254	1,158	-	505,952

Notes to the Financial Statements *(continued)*

3 Management of Risk *(continued)*

F – Credit Risk *(continued)*

	Neither due nor impaired	Financial assets that are past due but not impaired: Up to three months	Three to six months	Six months to one year	Greater than one year	Financial assets that have been impaired	Total
	£000	£000	£000	£000	£000	£000	£000
2017							
Shares and other variable yield securities and unit trusts	45,345	-	-	-	-	-	45,345
Debt securities	138,223	-	-	-	-	-	138,223
Overseas deposits as investments	65,750	-	-	-	-	-	65,750
Reinsurers' share of claims outstanding	83,432	-	-	-	-	-	83,432
Reinsurance debtors	1,320	-	-	-	-	-	1,320
Insurance debtors	37,411	11,062	1,607	1,427	798	-	52,305
Other debtors	60,193	-	-	-	-	-	60,193
Cash at bank and in hand	16,389	-	-	-	-	-	16,389
Total credit risk	448,063	11,062	1,607	1,427	798	-	462,957

G – Liquidity Risk

The Syndicate's whole account quota share reinsurance contract is denominated in the underlying settlement currencies of the Syndicate: Pounds Sterling ("GBP"), Euros ("EUR"), U.S. Dollars ("USD"), and Australian Dollars ("AUD"). The reinsured liabilities are matched by the currency assets held in a reinsurance trust fund and this provides currency risk mitigation. The reinsurance trust fund is also available to cash calls by the Syndicate and thereby supports its liquidity risk exposure.

The Syndicate is exposed to daily calls on its available cash resources, principally from claims arising from its insurance business. Liquidity risk arises where cash may not be available to pay obligations when due and maintain a liquidity position. The Syndicate's approach is to manage its cash flows so that it can reasonably survive a significant loss event. This means that the Syndicate maintains sufficient liquid assets, or assets that can be translated into liquid assets at short notice and without capital loss, to meet expected cash flow requirements.

These liquid funds are regularly monitored using cash flow forecasting to ensure that surplus funds are invested to achieve a higher rate of return. Regular cash flow monitoring ensures that maturing deposits are sufficient to meet cash calls. Additionally, intra-group reinsurance obligations are secured by funds deposited into a trust account to fund an amount equal to at least 100% of the obligations to the Syndicate.

We run stress tests to estimate the impact of a major catastrophe on our cash position in order to identify any potential issues. We also run scenario analyses that consider the impact on our liquidity should a number of adverse events occur simultaneously, such as an economic downturn and declining investment returns combined with unusually high insurance losses.

Notes to the Financial Statements *(continued)*

3 Management of Risk *(continued)*

G – Liquidity Risk *(continued)*

Our investment policy recognises the demands created by our underwriting strategy, so that some investments may need to be realised before maturity or at short notice. Hence a high proportion of our investments are in liquid assets, which reduces our risk of making losses because we may have to sell assets quickly.

The Syndicate has maintained and continues to maintain excellent liquidity. Historic large losses did not result in liquidity issues for the Syndicate.

Asset Liability Matching
The Syndicate reviews currency asset and liability positions on a regular basis. The currency net assets / (liabilities) positions denote the Syndicate's foreign exchange risk as a result of the translation of subordinated currency positions that are different to the reporting currency of the Syndicate. The main subordinate trading currencies are EUR, USD and AUD. The following table describes the net assets / (liabilities) positions at the year end.

	GBP £000	USD £000	EUR £000	CAD £000	AUD £000	JPY £000	OTH £000	Total £000
2018								
Financial investments	126,705	40,716	18,013	14,621	-	423	350	200,828
Overseas Deposits	-	875	-	2,711	62,379	-	6,261	72,226
Reinsurers' share of technical provisions	7,573	33,295	35,082	2,650	24,381	1,480	11,080	115,541
Insurance and reinsurance receivables	3,847	16,913	17,820	1,346	12,385	752	5,629	58,692
Cash at bank and in hand	2,178	4,344	2,255	-	746	-	3,243	12,766
Other assets	31,930	613	4,739	-	8,617	-	-	45,899
Total assets	172,233	96,756	77,909	21,328	108,508	2,655	26,563	505,952
Technical provisions	(25,548)	(112,326)	(118,354)	(8,940)	(82,254)	(4,993)	(37,379)	(389,794)
Insurance and reinsurance payables	(1,530)	(6,728)	(7,089)	(535)	(4,927)	(299)	(2,240)	(23,348)
Other creditors	(7,320)	(2,612)	(774)	-	(1,916)	-	-	(12,622)
Total liabilities	(34,398)	(121,666)	(126,217)	(9,475)	(89,097)	(5,292)	(39,619)	(425,764)

	GBP £000	USD £000	EUR £000	CAD £000	AUD £000	JPY £000	OTH £000	Total £000
2017								
Financial investments	117,540	40,581	12,378	12,334	-	389	346	183,568
Overseas Deposits	-	895	-	2,485	57,680	-	4,690	65,750
Reinsurers' share of technical provisions	6,984	29,372	23,878	2,706	26,477	1,479	12,026	102,922
Insurance and reinsurance receivables	3,639	15,304	12,440	1,410	13,796	770	6,266	53,625
Cash at bank and in hand	2,541	4,146	4,118	-	3,177	-	2,407	16,389
Other assets	23,966	7,364	3,876	-	5,497	-	-	40,703
Total assets	154,670	97,662	56,690	18,935	106,627	2,638	25,735	462,957
Technical provisions	(25,212)	(106,035)	(86,198)	(9,768)	(95,586)	(5,339)	(43,414)	(371,552)
Insurance and reinsurance payables	(776)	(3,264)	(2,654)	(301)	(2,943)	(164)	(1,336)	(11,438)
Other creditors	(17,031)	(5,878)	(736)	-	(774)	-	-	(24,419)
Total liabilities	(43,019)	(115,177)	(89,588)	(10,069)	(99,303)	(5,503)	(44,750)	(407,409)

Notes to the Financial Statements *(continued)*

3 Management of Risk *(continued)*

G – Liquidity Risk *(continued)*

The Syndicate manages the impact of currency fluctuations by attempting to ensure currency matching is maintained where feasible. In addition, as part of this process, currency trades may be made to maintain the desired currency net asset allocations. The Syndicate has established foreign exchange facilities with a number of banks to cater for these transactions.

Exchange Sensitivity Analysis

The following table describes the sensitivity to currency change on net assets.

	EUR Net Assets in GBP			USD Net Assets in GBP			AUD Net Assets in GBP		
	£000	+10% increase	-10% decrease	£000	+10% increase	-10% decrease	£000	+10% increase	-10% decrease
Net assets/ (liabilities) at 31 December 2018	-48,308	-4,831	4,831	-24,910	-2,491	2,491	19,411	1,941	-1,941
Net assets/ (liabilities) at 31 December 2017	-32,898	-3,290	3,290	-17,515	-1,752	1,752	7,324	732	-732

The above sensitivity analysis is based on the way the Syndicate manages the currencies exposure. The increase shown in the table above reflects the weakening of the currency shown against sterling and a decrease reflects the strengthening of the currency against sterling.

H – Counterparty Credit Risk

With regard to premium debtor risk, the Syndicate ensures that all brokers are subject to a due diligence protocol and that they have terms of business agreements in place. An approval system also exists for new brokers, and broker performance is regularly reviewed. System exception reports highlight trading with non-approved brokers, and the Syndicate's credit control team regularly monitors the ageing and collectability of debtor balances. Bank credit ratings and concentrations are also monitored at the Investment Committee.

The largest single reinsurer counterparty is Arch Reinsurance Ltd in respect of the internal quota share reinsurance. The internal reinsured claims outstanding in the Credit distribution of reinsurance receivables table above (Page 27) are included within the balance that has a credit rating of 'A+'. The balances due from Arch Reinsurance Ltd have further security in the form of a segregated trust to secure the liabilities. The value of the trust fund is required at all times to be greater than the reinsured liabilities, and the assets in trust are required to be invested to meet PRA admissibility rules. Bank credit ratings are monitored at the Investment Committee.

I – Regulatory Risk

This risk is affected by changes in law and regulations which are not identified, understood, or are inappropriately and incorrectly interpreted, or adopted, or business practices are not efficiently modified. Further, there is a risk that current legal or regulatory requirements are not complied with. We have a constructive and open relationship with our regulators.

Notes to the Financial Statements *(continued)*

3 Management of Risk *(continued)*

J – Conduct Risk

Conduct risk describes the Syndicate's behaviour that aims to provide appropriate products to the right group of consumers that achieve fair outcomes. The Syndicate's approach starts with our strong culture which means we consider and understand the needs of our customers and form an important cultural base to getting this right. From a risk management perspective, we facilitated the development of the conduct objective, the conduct risk appetite and the standards required to remain within this risk appetite. We are able to extract conduct-related controls from the risk register to provide the Board with assurance that the expected behaviours towards customers are being demonstrated.

K – Reputational Risk

Reputational risk is the risk of negative publicity as a result of the Syndicate's contractual arrangements, customers, products, services and other activities. Key sources of reputational risk include operation of a Lloyd's franchise and reliance upon the Arch brand in the United States, Europe and Australia. The Syndicate's preference is to minimise reputational risks, but where it is not possible or beneficial to avoid them, we seek to minimise their frequency and severity by management through public relations and communication channels.

L – Capital Risk

The Syndicate uses an Internal Capital Model for setting economic capital along with a number of other uses. The Syndicate follows a risk-based approach to determine the amount of capital required to support its activities. Recognised stochastic modelling techniques are used to measure risk exposures, and capital to support business activities is allocated according to risk profile. Stress and scenario analysis is regularly performed, and the results are documented and reconciled to the Board's risk appetite where necessary.

Capital framework at Lloyd's

Lloyd's is a regulated undertaking and subject to supervision by the PRA under the Financial Services and Markets Act 2000 and in accordance with the Solvency II Directive.

Within this supervisory framework, Lloyd's applies capital requirements at member level and centrally to ensure that Lloyd's complies with Solvency II, and beyond that to meet its own financial strength, licence and ratings objectives.

Although, as described below, Lloyd's capital setting processes use a capital requirement set at syndicate level as a starting point, the requirement to meet Solvency II and Lloyd's capital requirements apply at overall and member level, not at syndicate level. Accordingly, the capital requirement in respect of Syndicate 2012 is not disclosed in these annual accounts.

Lloyd's capital setting process

In order to meet Lloyd's requirements, each syndicate is required to calculate its Solvency Capital Requirement ("SCR") for the prospective underwriting year. This amount must be sufficient to cover a 1 in 200 year loss, reflecting uncertainty in the ultimate run-off of underwriting liabilities (SCR 'to ultimate').

The 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 Solvency II requirements. The SCRs of each syndicate are subject to review by Lloyd's and approval by the Lloyd's Capital and Planning Group. Over and above this, Lloyd's applies a capital uplift to the Member's capital requirement, to derive the Economic Capital Assessment ("ECA"). The purpose of this uplift, which is a Lloyd's not a Solvency II requirement, is to meet Lloyd's financial strength, licence and ratings objectives.

Notes to the Financial Statements *(continued)*

3 Management of Risk *(continued)*

L – Capital Risk *(continued)*

Provision of capital by members

Each member may provide capital to meet its ECA through any mixture of (i) assets held in trust by Lloyd's specifically for that member (funds at Lloyd's "FAL"), (ii) assets held in and managed within a syndicate (funds in syndicate "FIS"), or (iii) undistributed members' balances.

Capital Management

The Board of AUAL has in place policies and procedures for managing compliance with regulatory capital requirements and its own capital management objective. This objective is to balance risk and return while maintaining economic and regulatory capital in accordance with risk appetite. The Board of AUAL has no appetite for the Syndicate failing to maintain sufficient capital. To this end, AUAL recalculates its ECA routinely at different points during the annual business cycle, and may also recalculate the ECA on an ad hoc basis if the risk management framework identifies significant changes to the risk profile, or as required by the Board.

4 Accounting Policies

(a) *Insurance Contracts*

(i) Classification

Contracts under which the Syndicate accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder are classified as insurance contracts.

(ii) Recognition and measurement

Revenue

Premiums written relate to business incepted during the year, together with any differences between booked premiums for prior years and those previously accrued, and include estimates of premiums incepted but not yet received or notified to the Syndicate, less an allowance for cancellations. Premiums written are shown gross of commission payable to intermediaries, and exclude taxes and duties levied on premiums.

The earned proportion of premiums is recognised as revenue. Premiums are earned from the date of inception of risk on a time apportionment basis. In the opinion of the Directors the resulting earned proportion is not materially different from one based on the pattern of incidence of risk.

(ii) Recognition and measurement

Outward reinsurance premiums are accounted for in the same accounting year as the premiums for the related direct insurance or inwards reinsurance business. Reinsurance contracts that operate on a 'losses occurring' basis are accounted for in full over the year of coverage, whilst 'risk attaching' policies are expensed using the same earnings year as the underlying premiums on a daily pro rata basis.

Reinsurance commission income

Commissions on reinsurance premiums are earned in a manner consistent with the recognition of the costs of the reinsurance, generally on a pro-rata basis over the terms of the policies reinsured.

Notes to the Financial Statements *(continued)*

4 Accounting Policies *(continued)*

(a) *Insurance Contracts (continued)*

Unearned premium provision

Unearned premiums represent the proportion of premiums written in the year that relate to unexpired terms of policies in force at the balance sheet date calculated on a time apportionment basis. In the opinion of the Directors the resulting provision is not materially different from one based on the pattern of incidence of risk.

Claims

Claims incurred comprise notified claims and related expenses in the year together with changes in the estimates of what we ultimately expect to pay on claims based on facts and circumstances known at the balance sheet date. The insurance reserves include the Syndicate's total cost of claims IBNR.

Claims outstanding comprise provisions for the Syndicate's best estimate of the ultimate cost of settling all claims incurred but unpaid at the reporting date whether reported or not, and related internal and external claims handling expenses. Claims outstanding are assessed by reviewing individual reported claims and making allowance for claims incurred but not yet reported, the effect of both internal and external foreseeable events, such as changes in claims handling procedures, inflation, judicial trends, legislative changes and past experience and trends. Provisions for claims outstanding are not discounted. Adjustments to claims provisions established in prior periods are reflected in the financial statements of the period in which the adjustments are made and are disclosed separately if material. The methods used, and the estimates made, are reviewed regularly. The Syndicate's reserving policy is to use recognised actuarial techniques appropriate to the loss experience that exists. Where there is limited loss experience our choice of method has primarily been the expected loss method.

We select the initial expected loss and loss adjustment expense ratios based on information derived from our underwriters and actuaries during the initial pricing of the business, supplemented by industry data where appropriate. These ratios consider, amongst other things, rate changes and changes in terms and conditions that have been observed in the market. For a given underwriting year, additional weight is given to the historic paid and incurred loss development methods in the reserving process, assuming that case reserving practices are consistently applied over time. This reserving process makes some key assumptions that historical paid and reported development patterns are stable.

For a given underwriting year, additional weight is given to the historic paid and incurred loss development methods in the reserving process, assuming that case reserving practices are consistently applied over time. This reserving process makes some key assumptions that historical paid and reported development patterns are stable.

For catastrophe-exposed business, our reserving process also includes the use of catastrophe models for known events, a heavy reliance on analysis of individual catastrophic events and management judgement. The development of property losses can be unstable, especially for policies characterised by high severity, low frequency losses.

Reinsurance recoveries in respect of estimated claims incurred but not reported are booked in line with the underlying programme, adjusted to reflect changes in the nature and extent of the Syndicate's reinsurance programme over time. An assessment is also made of the recoverability of reinsurance recoveries having regard to market data on the financial strength of each of the reinsurance companies. Reinsurance liabilities are primarily premiums payable for reinsurance.

Unexpired risk provision

Provision is made for unexpired risks arising from contracts where the expected value of claims and expenses attributable to the unexpired periods of policies in force at the balance sheet date exceeds the unearned premiums provision in relation to such policies (after the deduction of any deferred acquisition costs). The provision for unexpired risks is calculated by reference to classes of business which are managed together, after taking into account the future investment return on investments held to back the unearned premiums and unexpired claims provisions.

Notes to the Financial Statements *(continued)*

4 Accounting Policies *(continued)*

(a) *Insurance Contracts (continued)*

(iii) Reinsurance assets

The Syndicate cedes reinsurance in the normal course of business for the purpose of limiting its net loss potential through the diversification of its risks. Assets, liabilities and income and expense arising from ceded reinsurance contracts are presented separately from the assets, liabilities, income and expense from the related insurance contracts because the reinsurance arrangements do not relieve the Syndicate from its direct obligations to its policyholders.

Amounts due to and from reinsurers are accounted for in a manner consistent with the insured policies and in accordance with the relevant reinsurance contract. For general insurance business, reinsurance premiums are expensed over the period that the reinsurance cover is provided based on the expected pattern of the reinsured risks. The unexpensed portion of ceded reinsurance premiums is included in reinsurance assets.

Reinsurance assets are assessed for impairment at each balance sheet date. A reinsurance asset is deemed impaired if there is objective evidence, as a result of an event that occurred after its initial recognition, that the Syndicate may not recover all amounts due, and that the event has a reliably measurable impact on the amounts that the Syndicate will receive from the reinsurer. Impairment losses on reinsurance assets are recognised in the comprehensive income for the period.

(iv) Deferred acquisition costs

Acquisition costs which represent commission and other related underwriting expenses are deferred over the year in which the related premiums are earned. The deferred expenses relate to underwriter salaries, office costs, and marketing which are deferred based on a ratio between bound and quoted policies by line of business. To the extent that acquisition costs are deferred and considered irrecoverable against the related unearned premiums, they are written off to net operating expenses as incurred.

The deferred acquisition cost represents the proportion of acquisition costs which corresponds to the proportion of gross premiums written that is unearned at the balance sheet date. The acquisition costs are expensed from the date of inception of risk on a time apportionment basis.

(b) Financial Instruments

(i) Non-derivative financial assets

The Syndicate initially recognises loans and receivables and deposits on the date that they are originated. Financial assets are recognised initially at cost on the trade date and subsequently measured at amortised cost.

The Syndicate derecognises a financial asset when the contractual rights to the cash flows from the asset expire, or it transfers the rights to receive the contractual cash flows on the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred.

Any interest in transferred financial assets that is created or retained by the Syndicate is recognised as a separate asset or liability.

Financial assets and liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Syndicate has a legal right to offset the amounts and intends to either settle on a net basis or to realise the asset and settle the liability simultaneously.

Non-derivative financial assets comprise investments in equity and debt securities, trade receivables, and cash and cash equivalents.

Notes to the Financial Statements *(continued)*

4 Accounting Policies *(continued)*

(b) Financial Instruments (continued)

(ii) Fair value through profit and loss financial assets

The Syndicate's investments in debt securities are classified as fair value through profit and loss financial assets. Subsequent to initial recognition, they are measured at fair value and changes therein are recognised in the profit and loss account.

The fair value is determined based on the fair value hierarchy, which defined by the standard are as follows:

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

(iii) Cash and cash equivalents

Cash and cash equivalents comprise cash balances and call deposits with original maturities of three months or less. Bank overdrafts that are repayable on demand and form an integral part of the Syndicate's cash management are included as a component of cash and cash equivalents for the purposes of the statement of cash flows.

(iv) Non-derivative financial liabilities

Financial liabilities are recognised initially at cost on the trade date at which the Syndicate becomes a party to the contractual provisions of the instrument and subsequently measured at amortised cost.

The Syndicate derecognises a financial liability when its contractual obligations are discharged or cancelled or expire.

Financial assets and liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Syndicate has a legal right to offset the amounts and intends to either settle on a net basis or to realise the asset and settle the liability simultaneously. The Syndicate has the following non-derivative financial liabilities: bank overdrafts, insurance and other payables and other liabilities.

(c) Taxation

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

No provision has been made for any United States Federal Income Tax payable on underwriting results or investment earnings. Any payments on account made by the Syndicate during the year are included in the balance sheet under the heading "Other Debtors".

No provision has been made for any other overseas tax payable by the Corporate Member on underwriting results.

(d) Functional Currency

The Syndicate's functional and reporting currency is pounds sterling ("GBP").

Notes to the Financial Statements *(continued)*

4 Accounting Policies *(continued)*

(d) Functional Currency (continued)

The results and financial positions of the non-settlement currencies are retranslated into the reporting currency as follows:

- monetary assets and liabilities are retranslated at the closing rate at the balance sheet date;
- income and expenses are retranslated at the average rate of exchange during the year; and
- all resulting exchange differences are recognised through the Non-Technical account.

5 Segmental Information

Segmental information required by The Insurance Accounts Directive (Lloyd's Syndicate and Aggregate Accounts) Regulations 2008 is as follows:

	Gross Premium Written 2018 £000	Gross Premium Earned 2018 £000	Gross Claims Incurred 2018 £000	Gross Operating Expenses 2018 £000	Ceded Balance 2018 £000	Total 2018 £000
Direct						
Accident & health	58,034	60,214	(35,559)	(24,451)	(850)	(646)
Marine	39,064	37,590	(30,306)	(13,625)	(50)	(6,391)
Fire & other damage to property	49,151	46,987	(15,358)	(16,993)	(8,876)	5,760
Third party liability	85,446	84,448	(47,682)	(30,818)	(986)	4,962
Direct Total	231,695	229,239	(128,905)	(85,887)	(10,762)	3,685
Reinsurance						
Accident & health	309	361	-	(34)	(33)	294
Reinsurance Total	309	361	-	(34)	(33)	294
Total	232,004	229,600	(128,905)	(85,921)	(10,795)	3,979

	Gross Premium Written 2017 £000	Gross Premium Earned 2017 £000	Gross Claims Incurred 2017 £000	Gross Operating Expenses 2017 £000	Ceded Balance 2017 £000	Total 2017 £000
Direct						
Accident & health	50,408	54,736	(35,629)	(22,470)	(889)	(4,252)
Marine	31,238	34,255	(20,728)	(12,560)	(3,088)	(2,121)
Fire & other damage to property	41,906	38,394	(43,939)	(16,035)	5,082	(16,498)
Third party liability	75,695	76,937	(41,222)	(32,260)	(5,968)	(2,513)
Direct Total	199,247	204,322	(141,518)	(83,325)	(4,863)	(25,384)
Reinsurance						
Accident & health	649	679	560	(38)	(193)	1,008
Reinsurance Total	649	679	560	(38)	(193)	1,008
Total	199,896	205,001	(140,958)	(83,363)	(5,056)	(24,376)

Notes to the Financial Statements *(continued)*

5 Segmental Information *(continued)*

The reinsurance balance represents the charge or benefit to the technical account from the aggregate of all items relating to outwards reinsurance.

The geographical analysis of gross written premiums by reference to the location of the assured is as follows:

	2018 £000	2017 £000
United Kingdom	43,859	35,015
EU member states excluding the United Kingdom	43,347	35,266
Australia	78,415	65,373
United States of America	14,109	14,284
South Africa	6,635	10,412
Other including worldwide exposures	45,639	39,546
	232,004	199,896

All premiums were concluded in the UK.

6 Operating Expenses

Within gross operating expenses are included commissions for direct insurance of £54.8m in 2018 (2017: £49.9m).

	2018 £000	2017 £000
Acquisition costs	(63,500)	(56,548)
Change in deferred acquisition costs	(835)	(2,975)
Administrative expenses	(21,586)	(23,840)
Reinsurance commissions and profit participation	16,606	14,588
	(69,315)	(68,775)

Administrative expenses include:

	2018 £000	2017 £000
Fees payable to the Syndicate's auditors and their associates for the audit of the Syndicate's annual accounts	(88)	(88)
Audit of subsidiaries	-	-
Audit services pursuant to regulation	(148)	(141)
Other Services	(12)	(12)
Total	(248)	(241)

Notes to the Financial Statements *(continued)*

7 Investment Income

	2018 £000	2017 £000
Interest and similar income		
From financial instruments designated as at fair value through profit or loss	3,026	2,356
From investments designated as at fair value through profit or loss		
Net (losses) on realisation of investments	(869)	(329)
Unrealised (losses) on investments	(81)	(1,723)
Total Investment income	**2,076**	**304**

8 Directors' Remuneration and Employee Costs

(a) Directors' remuneration

The Directors of AUAL and the Active Underwriter received the following aggregate remuneration charged to the Syndicate during the year:

	2018 £000	2017 £000
Directors of the Managing Agent	794	1,505
Active Underwriter	250	177

Further information in respect of the Directors of AUAL is provided in that Managing Agent's financial statements.

(b) Employee Costs

The average number of staff employed by Arch Europe Insurance Services Ltd ("AEIS"), but working for the Syndicate during the year, analysed by category is as follows:

	2018	2017
Underwriting	35	32
Administration and finance	40	36
Claims	12	12
	87	80

The Managing Agent has a service and secondment agreement with AEIS, whereby staff employed by AEIS are provided to the Managing Agent.

	2018 £000	2017 Restated £000
Salaries	8,536	8,062
Social security costs	909	1,285
Other pension costs	682	627
	10,127	9,974

The figures above have been restated for 2017 to include the director cost from note 8 (a) which were previously not disclosed within the total employee cost.

Notes to the Financial Statements *(continued)*

9 Other Debtors and Creditors

	2018 £000	2017 £000
Amounts due from associated undertakings	16,704	12,690
Amounts due to associated undertakings	(6,073)	(18,404)
	10,631	(5,714)

10 Other Assets

	2018 £000	2017 £000
Claims Funds	7,722	6,244
	7,722	6,244

11 Accruals and Deferred Income

	2018 £000	2017 £000
Deferred ceding commissions	6,549	6,015
	6,549	6,015

12 Financial Investments

	Fair Value 2018 £000	Cost 2018 £000	Fair Value 2017 £000	Cost 2017 £000
Shares and other variable yield securities				
Short term & cash equivalents	32,423	32,424	39,816	39,820
Other investments	2,762	2,762	5,529	5,529
	35,185	35,186	45,345	45,349
Debt securities and other fixed income securities				
Sovereign & government agency	140,767	141,400	127,232	128,272
Corporate bonds	17,191	16,790	10,169	10,028
Other investments	7,685	7,542	822	789
	165,643	165,732	138,223	139,089

The Managing Agent believes that the carrying value of the investments is supported by their underlying net assets. The financial investments shown above are all listed investments.

Notes to the Financial Statements *(continued)*

12 Financial Investments *(continued)*

The fair values above were determined using the fair value hierarchy as defined in Note 4 (b) (ii). The split by level is:

As at 31 December 2018

	Level 1 £000	Level 2 £000	Level 3 £000
Other variable yield securities	3,620	31,565	-
Debt securities and other fixed income securities	14,048	151,595	-
Overseas Deposits	3,698	68,528	-
	21,366	251,688	-

As at 31 December 2017

	Level 1 £000	Level 2 £000	Level 3 £000
Other variable yield securities	11,784	33,561	-
Debt securities and other fixed income securities	11,242	126,981	-
Overseas Deposits	1,928	63,822	-
	24,954	224,364	-

13 Technical Provisions

(a) Summary of net technical provisions:

	Gross 2018 £000	Ceded 2018 £000	Net 2018 £000	Gross 2017 £000	Ceded 2017 £000	Net 2017 £000
Notified claims	138,040	(41,303)	96,737	114,951	(31,117)	83,834
IBNR (incl ULAE)	172,891	(51,635)	121,256	181,877	(52,314)	129,562
Unearned Premium	78,863	(22,603)	56,260	74,724	(19,491)	55,233
Total	389,794	(115,541)	274,253	371,552	(102,922)	268,629

Notes to the Financial Statements *(continued)*

13 Technical Provisions *(continued)*

(b) Reconciliation of claims technical provisions:

	2018	Restated 2017
	£000	**£000**
Net claims technical provisions brought forward		
Outstanding claims	83,834	71,118
IBNR claims	129,562	121,603
	213,396	192,721
Losses incurred in the year		
Current accident year	105,552	111,149
Prior accident years	(8,546)	(4,097)
	97,006	107,052
Paid losses		
Current accident year	(7,784)	(17,595)
Prior accident years	(85,954)	(74,032)
	(93,738)	(91,627)
Foreign exchange differences	1,329	5,250
Net claims technical provisions carried forward		
Outstanding claims	96,737	83,834
IBNR claims	121,257	129,562
	217,993	213,396

Notes to the Financial Statements *(continued)*

13 Technical Provisions *(continued)*

(c) Gross claims development triangles – by underwriting year

Underlying Pure Year	At end of u/w year £000	One year later £000	Two years later £000	Three years later £000	Four years later £000	Five years later £000	Six years later £000	Seven years later £000	Cumulative payments £000	Outstanding reserves £000
2011	41,115	112,309	119,247	116,085	112,110	113,649	113,249	112,174	100,723	11,451
2012	39,290	81,305	75,247	75,080	74,375	71,126	71,757	-	52,906	18,851
2013	55,806	110,900	116,210	118,668	113,048	105,390	-	-	86,273	19,117
2014	42,194	96,810	110,132	110,399	117,774	-	-	-	80,597	37,177
2015	40,886	106,813	119,966	120,074	-	-	-	-	84,786	35,289
2016	43,343	120,913	132,032	-	-	-	-	-	66,300	65,731
2017	65,496	138,398	-	-	-	-	-	-	63,229	75,169
2018	47,067	-	-	-	-	-	-	-	4,697	42,370
Total	**375,197**	**767,448**	**672,834**	**540,306**	**417,307**	**290,165**	**185,006**	**112,174**	**539,511**	**305,155**

	Cumulative payments	Outstanding reserves
2010 & Prior	82,668	5,776
Total	**622,179**	**310,931**

(d) Net claims development triangles – by underwriting year

Underlying Pure Year £000	At end of u/w year £000	One year later £000	Two year later £000	Three year later £000	Four years later £000	Five years later £000	Six years later £000	Seven years later £000	Cumulative payments £000	Outstanding reserves £000
2011	28,714	77,324	78,881	75,710	75,404	76,758	75,843	75,664	67,884	7,780
2012	28,806	64,271	59,878	60,147	59,961	58,756	57,816	-	44,731	13,085
2013	39,820	76,476	79,860	82,413	78,974	74,009	-	-	59,946	14,064
2014	31,365	70,957	81,340	82,799	86,088	-	-	-	62,344	23,744
2015	30,253	80,488	91,912	92,960	-	-	-	-	67,565	25,395
2016	32,346	93,721	103,656	-	-	-	-	-	54,275	49,381
2017	44,267	104,416	-	-	-	-	-	-	51,353	53,063
2018	30,196	-	-	-	-	-	-	-	4,171	26,026
Total	**265,767**	**567,653**	**495,527**	**394,029**	**300,427**	**209,523**	**133,659**	**75,664**	**412,269**	**212,538**

	Cumulative payments	Outstanding reserves
2010 & Prior	69,360	5,455
Total	**481,629**	**217,993**

The movement in prior year's provisions for net claims outstanding was a decrease of £2.3 million.

Notes to the Financial Statements *(continued)*

13 Technical Provisions *(continued)*

The tables below show the movements that occurred in the insurance provisions and related reinsurance assets during the year.

Claims Provisions

	Gross 2018	Ceded 2018	Net 2018	Restated Gross 2017	Ceded 2017	Restated Net 2017
	£000	£000	£000	£000	£000	£000
At 1 January	296,828	(83,432)	213,396	267,287	(74,566)	192,721
Movement per technical account	11,052	(7,784)	3,268	27,266	(11,840)	15,426
Exchange rate impact	3,051	(1,722)	1,329	2,275	2,974	5,249
31 December	310,931	(92,938)	217,993	296,828	(83,432)	213,396

Unearned Premiums

	Gross 2018 £000	Ceded 2018 £000	Net 2018 £000	Gross 2017 £000	Ceded 2017 £000	Net 2017 £000
At 1 January	74,724	(19,491)	55,233	83,350	(20,046)	63,304
Movement per technical account	2,404	(2,642)	(238)	(5,105)	70	(5,035)
Exchange Rate Impact	1,735	(470)	1,265	(3,521)	485	(3,036)
31 December	78,863	(22,603)	56,260	74,724	(19,491)	55,233

14 Funds at Lloyd's (FAL)

Arch Syndicate Investments Ltd is the sole Member of Syndicate 2012 and has funded the FAL set by Lloyd's through a combination of collateralised letters of credit and share capital. Collateralised letters of credit totalling £117.8m (2017: £110.8m) are provided by Arch Reinsurance Ltd on behalf of Arch Syndicate Investments Ltd and hence do not form part of these financial statements. The increase from prior year is due to foreign exchange fluctuations as the LOC contract is held in US Dollars.

The remaining element of the FAL requirement amounts to £124.8m (2017: £105.7m) and this has been deposited into premium trust funds of Syndicate 2012 by Arch Syndicate Investments Ltd. The deposit is designated as Funds in Syndicate and forms part of Member's Balance. In total the Syndicate received additional capital contribution from Arch Reinsurance Ltd in 2018 totalling £25.5m (2017: £nil) to support the 2019 business plan.

15 Related Parties

Syndicate 2012 is managed by AUAL. The Directors of AUAL regard ACGL, a Company incorporated in Bermuda, as the ultimate holding company and controlling party. Copies of the consolidated financial statements of ACGL can be obtained from The Secretary, Arch Capital Group Ltd., Waterloo House, Ground Floor, 100 Pitts Bay Road, Pembroke HM08, Bermuda.

Notes to the Financial Statements *(continued)*

15 Related Parties *(continued)*

Arch Reinsurance Ltd.

Syndicate 2012 has a whole account quota share reinsurance contract of 15.0% (2017: 15.0%) with Arch Reinsurance Ltd. The Syndicate ceded £30.0 m (2017: £25.8m) of net written premiums during the 2018 financial year. The effect of the quota share contract reduced net underwriting losses by £0.8 m (2017 reduced by £2.1m) in the 2018 financial year.

Arch Underwriting at Lloyd's Ltd ("AUAL")

AUAL is the Managing Agent of Syndicate 2012. During 2018 the Syndicate paid the Managing Agent £415,000 (2017: £415,000) as a managing agency fee. The Managing Agent entered into a service and secondment agreement with Arch Europe Insurance Services Ltd ("AEIS"), whereby AEIS provides services in the form of staff and facilities to the Managing Agent.

Arch Underwriting at Lloyd's (Australia) Pty Ltd ("AUALA")

This service company is wholly owned by the Managing Agent and is authorised to bind business on behalf of Syndicate 2012. During 2018 AUALA has bound £23.3 m (2017: £19.8m) of gross written premiums on behalf of Syndicate 2012. The Syndicate has incurred a net profit of £0.5 m (2017: loss £0.8m) on the business bound by the service company for the year ended 31 December 2018.

Arch Underwriting Managers at Lloyd's (South Africa) Pty Ltd ("AUMALSA")

This service company was wholly owned by the Managing Agent and was authorised to bind business on behalf of Syndicate 2012. During 2018 AUMALSA bound £7.2m (2017: £11.7m) of gross written premiums on behalf of Syndicate 2012. On 1 October 2018 the Managing Agent sold AUMALSA. All liabilities prior to disposal will be run off by the Syndicate 2012.

Arch Syndicate Investments Ltd

The Syndicate is supported by Arch Syndicate Investments Ltd, which provides 100% of its underwriting capacity, see note 14.

Arch Underwriting Agency (Australia) Pty. Ltd. ("AUAAPL")

This service company is wholly owned by the Managing Agent and is authorised to bind business on behalf of Syndicate 2012. During 2018 AUAAPL has bound £nil (2017: £nil) of gross written premiums on behalf of Syndicate 2012. The gross written premiums in 2018 are aggregated within the AUALA bound premiums and therefore form part of the £23.3m.

Axiom Underwriting Agency Limited ("Axiom")

The Managing Agent owns 75.0% of Axiom which is authorised to bind business on behalf of Syndicate 2012. During 2018, Axiom has bound £1.3 m (2017: £0.9 m) of gross written premiums on behalf of the Syndicate.

Notes to the Financial Statements *(continued)*

16 Restatements

Restated Statement of Cash Flow

Below table shows line presentation changes in Cash Flow statement to ensure that 2017 & 2018 are on the same basis as figures were previously incorrectly presented in the financial statements.

			At 31 Dec 2017	
Reconciliation of operating profit/(loss) to net cash inflow from operating activities	**Note**	**Previously Stated £000**	**Restatement £000**	**Restated £000**
Operating (loss) on ordinary activities		(26,880)	-	(26,880)
Increase in gross technical provisions		31,359	-	31,359
(Increase) in reinsurers' share of gross technical provisions		(11,363)	-	(11,363)
Increase in debtors	A	5,815	14,340	20,155
Increase in creditors		1,732	-	1,732
(Increase) in other assets / liabilities	A	-	(14,340)	(14,340)
(Increase)/ decrease in unrealised investment return	B	1,723	(2,027)	(304)
Increase in market value and currency	C	3,417	123	3,540
Foreign exchange on cash and cash equivalents	C	-	(123)	(123)
Net cash inflow/ (outflow) from operating activities		**5,803**	**(2,027)**	**3,776**
Purchase of equity and debt instruments	B	(232,939)	2,027	(230,912)
Sale of equity and debt instruments		227,957	-	227,957
Net cash outflow from investing activities		**(4,982)**	**2,027**	**(2,955)**
Net decrease in cash and cash equivalents		821	-	821
Cash at bank and in hand at beginning of year		15,568	-	15,568
Cash at bank and in hand at end of year		16,389	-	16,389

Note A represents a reclassification of £14.3 million between increase in debtors and the movement in other assets liabilities.

Note B represents a reclassification of £2.0 million between increase / decrease in unrealised investment return debtors and the purchase of equity debt instruments.

Note C represents a reclassification of £0.1 million between increase in market value and currency and the foreign exchange on cash and cash equivalents.

Restated Statement of Profit and Loss Account: Technical Account – General Business

A restatement has been made between claims paid gross and change in the provisions for gross claims in 2017 for £4,634,023. This is to reflect the change in accounting policy made in 2017 related to how we account for paid claims during the early cut off period in our technical results. The balance sheet impact was reflected in the 2017 accounts but the profit and loss account impact has been shown as restatement in 2018.

Directors of the Managing Agent and Administration

Directors of the Managing Agent as at 21 March 2019

S. Bashford
N. Denniston
J. Kittinger
P. Leoni
P. Martin
M. Shulman
P. Storey

Company Secretary

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