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Syndicate 2012

Annual Report and Accounts
For the year ended 31 December 2019

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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 2019.

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

Principal Activities

Syndicate 2012 currently underwrites Casualty, Directors and Officers Liability, Marine, Onshore and Offshore Energy, Professional Lines, Property, Personal Accident and Private Medical Insurance, Reinsurance and Terrorism. The business is classified into underwriting units comprising: Accident and Health, Marine, Fire & Other Damage to Property and Third Party Liability.

Business Review

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

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

Our underwriting philosophy is to generate an underwriting profit through prudent risk selection and appropriate pricing across 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 three direct subsidiary undertakings: two incorporated in Australia and one in the United Kingdom. Arch Underwriting at Lloyd's (Australia) Pty Ltd, Arch Underwriting Agency (Australia) Pty Ltd and Axiom Underwriting Agency Limited ("Axiom") are licensed to trade as Lloyd's service companies with authority to bind risks on behalf of Syndicate 2012. The focus for 2019 has continued to be the development of infrastructure and portfolios of profitable business. As part of this strategy, on 1 January 2019, the Managing Agent exercised the option to purchase the remaining 25% of Axiom, resulting in 100% ownership of the subsidiary.

Strategic Report *(continued)*

Business Review *(continued)*

Review of the Business

The Syndicate recorded an underwriting profit before investment income of £15.0m (2018: profit £4.0m), mainly driven by the favourable prior year releases and total comprehensive profit of £22.3m (2018: loss £0.8m) driven by a non- technical profit of £6.9m (2018: loss £5.0m). The components are described below:

Key Performance Information and Metrics	**2019** **£m**	**2018** **£m**
Gross premiums written	223.9	232.0
Net premiums written	157.4	170.1
Earned premiums, net of reinsurance	160.2	170.3
Claims incurred, net of reinsurance	(85.2)	(97.0)
Net underwriting expense	(59.9)	(69.3)
Allocated investment income	0.3	0.2
Balance on technical account for general business	15.0	4.0
Investment return and foreign exchange	6.9	(5.0)
Total profit for the year	22.3	(0.8)
Claims ratio	53.2%	56.9%
Expense ratio	37.4%	40.7%
Combined ratio	90.6%	97.6%

Premiums written

Gross written premiums of £223.9m are 3.5% lower than 2018. During 2019 the Syndicate continued its strategy of capitalising on profitable underwriting opportunities and discontinuing unprofitable lines of business. This resulted in the non-renewal of the 1Cover travel binder, which wrote premiums of £37.1m in 2018. The loss of premiums from the 1Cover binder was offset by an increase in other lines of business driven by both, rate increases as well as a general growth of the books of business. Syndicate wrote £1.6m in Political Risk, a new line of business in 2019. We have seen a positive rate changes across all lines of business, the largest are Directors and Officers (35.2%), Onshore Energy (30.8%) and Hull (19.1%).

Claims incurred

The 2019 underwriting year has been a benign year with regards to claims experience. The market has experienced a relatively mild hurricane season and the Syndicate has limited exposure on market events, such as hurricane Dorian and the Australian bushfires.

As a result, losses and loss adjustment expenses decreased by £11.8m to £85.2m (2018: £97.0) with the loss ratio decreasing from 56.9% in 2018 to 53.2% in 2019, contributing to an overall underwriting profit of £22.3m.

Operating Expenses

Net operating expenses, which include acquisition costs and other operating expenses, decreased by £9.4m to £59.9m (2018: £69.3m). £5.5m of the decrease is driven by a decrease in acquisition costs due to changes in the business written. In particular, the non-renewal of the 1Cover travel binder contributed to an improvement in acquisition expense ratio, as the travel premiums carried higher commission rates than the Syndicate's remaining lines of business.

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.

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.

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

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.

Strategic Report *(continued)*

Risk management strategy and risk appetite *(continued)*

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; and • Stress and scenario testing.

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

The Syndicate has had a successful financial year, with total profits of £22.3m (2018: loss £0.9m). Whilst the non-renewal of 1Cover resulted in a drop of premiums written, the impact was mitigated by an increase in rates and general growth in the remaining lines of business.

Looking to 2020, we look to capitalise on the increase in rates observed across the market and continue to focus on underwriting discipline, with the aim of improving the combined ratio to achieve an operating return on average equity of 12% or greater over the insurance cycle. The Syndicate's governance and underwriting controls continue to place strong emphasis on risk selection and price adequacy, contributing to overall underwriting discipline.

Strategic Report *(continued)*

Outlook and Future Developments *(continued)*

Brexit

Brexit has continued to be a source of considerable uncertainty over 2019, and our Brexit strategy has been based on the scenario that UK insurance companies, including Lloyd's Syndicates will not be permitted to conduct insurance business in the European Economic Area (EEA).

Our strategy is broadly summarised as follows:

- EEA business written on the Lloyd's platform has been placed using the Lloyd's Insurance Company (LIC) in Brussels from 1 January 2019.
- For all valid claims on EEA policies incepting before this date, Arch will apply all legal means and options to ensure that we are able to service our contracts and to pay claims, with an expectation that the Lloyd's Part VII transfer to the LIC is completed before the end of 2020.

The plans set out above have ensured that we retain the ability to write and service European business following the UK's withdrawal.

Climate Change

The directors have made an assessment of the risk of climate change to the Syndicate and have identified potential risks to relating to physical property, liability, transition risk (i.e. risks occurring when moving towards a greener economy) and other areas. In the short term it has been concluded that:

- No adjustments are currently required to catastrophe or pricing models.
- The investment strategy is not expected to be impacted based on the current investment holdings.
- Reputational risk may be material as the impact of climate change becomes a focus of stakeholders such as investors, insureds and employees, and further work is being carried out to understand Arch's ESG (Environmental, Social and Corporate Governance) strategy going forward.
- It is also anticipated that regulatory risk will increase, with additional focus from regulators and reporting expected to be included in key outgoing documents.
- A number of scenarios have been considered based on the PRA's 2019 General Insurance Stress Test climate change specifications, which show that these could be a long-term impact to modelled losses relating to US Windstorm exposures, although it is anticipated that we would remain within current risk appetites.

In line with the PRA's expectations in SS3/19 and PS11/19, an initial plan has been put in place considering governance, risk management, scenario analysis and disclosure.

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

Pasquale Leoni
Director
Arch Underwriting at Lloyd's Ltd
05 March 2020

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 $13.2bn (2018: $11.2bn) of shareholder capital as at 31 December 2019. ACGL provides insurance, reinsurance and mortgage insurance on a worldwide basis through its operations in Bermuda, the United States of America, Europe, Canada, and Australia. ACGL is listed on the Nasdaq Stock Market.

Directors

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

S. Bashford	Chief Underwriting Officer	
N. Denniston	Non-Executive and Chairman	
J. Kittinger	Finance Director	
P. Leoni	Chief Underwriting Officer	
P. Martin	Non-Executive	
J. Mentz	Director	(Appointed 18 March 2019)
M. Shulman	President and Chief Executive Officer	(Resigned 18 March 2019)
P. Storey	Non-Executive	
H. Sturgess	President and Chief Executive Officer	(Appointed 18 March 2019)

The Directors are covered by third party indemnity insurance policies.

Business Review

Please refer to the Strategic Report on page 1.

Outlook and Future Developments

Please refer to Strategic Report on page 7.

Financial Instruments

The financial risk management objectives and policies of the syndicate are given in the Strategic Report on pages 3-7 and in Note 4. Details of the exposure of the syndicate to financial risk are given in Note 4.

Donations

The Syndicate made no political or charitable contributions during the year (2018: £nil).

Financial Risk Management

The Syndicate's mission is to generate positive contribution to the growth in the Tangible Book Value of our ultimate parent company. We do this by maximising our return on equity within a defined 'risk appetite'. It is essential that we understand the risks the Syndicate is exposed to, namely strategic risk, insurance risk, operational risk, market risk, credit risk, liquidity risk, counterparty risk, regulatory risk, conduct risk, reputation risk and capital risk. Note 4 expands on these risks, including the Syndicate's management of these risks.

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 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 Director is aware, there is no information relevant to the audit of the Syndicate's annual accounts for the year ended 31 December 2019 of which the auditors are unaware; and
- Each Director has taken all the steps that they ought to have taken in their duty as a Director 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.

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

Independent Auditors' Report to the Member 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 2019 and of its profit and cash flows for the year then ended;
- have been properly prepared in accordance with 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 2019; the profit and loss account: technical account – general business, the profit and loss account: non-technical account, the statement of comprehensive income, the statement of cash flows, the statement of changes in member's balance for the year then ended; and the notes to the syndicate annual accounts, which include a description of the 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 of the United Kingdom's withdrawal 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 Member 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 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 The 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 2019 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 Responsibilities set out on page 10, 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.

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

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.

Use of this report
This report, including the opinions, has been prepared for and only for the syndicate's member 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
- adequate accounting records have not been kept by the Managing Agent in respect of the syndicate; 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
05 March 2020

Profit and Loss Account: Technical Account – General Business

For the year ended 31 December 2019

	Notes	2019 £000	2018 £000
Earned premium, net of reinsurance			
Gross premiums written	6	223,899	232,004
Outward reinsurance premiums		(66,468)	(61,939)
Net premiums written		157,431	170,065
Change in the gross provision for unearned premiums		(1,983)	(2,404)
Change in the provision for unearned premiums, reinsurers' share		4,724	2,642
Earned premiums, net of reinsurance		160,172	170,303
Allocated investment return transferred from the non-technical account		432	169
Total technical income		**160,604**	**170,472**
Claims incurred, net of reinsurance			
Claims paid			
-gross amount		(100,268)	(117,853)
-reinsurers' share		26,107	24,115
	14	(74,161)	(93,738)
Change in the provision for claims			
-gross amount		(9,527)	(11,052)
-reinsurers' share		(1,559)	7,784
		(11,086)	(3,268)
Claims incurred, net of reinsurance	14	(85,247)	(97,006)
Net operating expenses	7	(59,934)	(69,315)
Total technical charges		**(145,181)**	**(166,321)**
Balance on the technical account for general business		**15,423**	**4,151**

All Operations are continuing.

The notes on pages 18 to 42 form part of these financial statements.

Profit and Loss Account: Non-Technical Account
For the year ended 31 December 2019

	Notes	2019 £000	2018 £000
Balance on the general business technical account		15,423	4,151
Investment income		3,820	3,094
Gains on the realisation of investments		1,682	149
Investment expenses and charges		(248)	(69)
Losses on the realisation of investments		(178)	(1,018)
Unrealised gain / losses on investments		491	(80)
	8	5,567	2,076
Allocated investment return transferred to the general business technical account		(2,053)	(169)
Non-technical profit / (loss) on exchange		3,356	(6,918)
Total profit / (loss) for the year		**22,293**	**(860)**

Statement of Comprehensive Income
For the year ended 31 December 2019

	2019 £000	2018 £000
Profit / (loss) for the financial year	22,293	(860)
Other comprehensive income	-	-
Other comprehensive income for the year	-	-
Total comprehensive income for the year	**22,293**	**(860)**

All results are attributable to continuing operations.

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

The notes on pages 18 to 42 form part of these financial statements.

Balance Sheet
As at 31 December 2019

	Notes	2019 £000	2018 £000
ASSETS			
Financial Investments			
Shares and other variable-yield securities	*13*	42,203	35,185
Debt securities and other fixed-income securities	*13*	184,881	165,643
		227,084	**200,828**
Reinsurers' share of technical provisions			
Provision for unearned premiums	*14*	26,747	22,603
Claims outstanding		87,500	92,938
	14	**114,247**	**115,541**
Debtors			
Debtors arising out of direct insurance operations		52,591	53,044
Debtors arising out of direct reinsurance operations		4,896	5,647
Other debtors	*10*	9,599	16,704
		67,086	**75,395**
Other assets			
Cash at bank and in hand		15,922	12,766
Overseas deposits	*13*	60,158	72,226
Other assets	*11*	10,359	7,722
		86,439	**92,714**
Prepayments and accrued income			
Deferred acquisition costs		19,026	20,035
Other prepayments and accrued income		1,184	1,439
TOTAL ASSETS		**515,066**	**505,952**
LIABILITIES			
Capital and reserves			
Member's balance		103,440	80,188
Technical provisions			
Provision for unearned premiums	*14*	78,065	78,863
Claims outstanding		308,186	310,931
	14	**386,251**	**389,794**
Creditors			
Creditors arising out of reinsurance operations		16,848	23,348
Other creditors	*10*	1,999	6,073
		18,847	**29,421**
Accruals and deferred income	*12*	6,528	6,549
TOTAL LIABILITIES		**515,066**	**505,952**

The notes on pages 18 to 42 form part of these financial statements

The financial statements on pages 14 to 17 were approved by the Board of Arch Underwriting at Lloyd's Ltd on 05 March 2020 and were signed on their behalf by:

Jason Kittinger
Finance Director
Arch Underwriting at Lloyd's Ltd
05 March 2020

Statement of Changes in Member's Balance
As at 31 December 2019

	2019 £000	2018 £000
Brought forward at 1 January 2019	80,188	55,548
Profit / (loss) for the financial year	22,293	(860)
Capital Contribution	959	25,500
Member's balances carried forward at 31 December 2019	**103,440**	**80,188**

The notes on pages 18 to 42 are an integral part of these financial statements.

Statement of Cash Flows
For the year ended 31 December 2019

Reconciliation of operating profit / (loss) to net cash inflow from operating activities	**2019 £000**	**2018 £000**
Operating profit / (loss) on ordinary activities	22,293	(860)
Increase in gross technical provisions	10,747	14,662
(Increase) in reinsurers' share of gross technical provisions	(2,942)	(11,627)
(Increase) / decrease in debtors	4,150	(9,488)
(Decrease) in creditors	(9,517)	(337)
Increase / (decrease) in other assets / liabilities	9,571	(9,022)
Investment return	(5,566)	(2,076)
Change in market value and currency	1,950	4,847
Foreign exchange on cash and cash equivalents	(324)	164
Net cash Inflow / (Outflow) from operating activities	**30,362**	**(13,737)**
Purchase of equity and debt instruments	(354,466)	(242,492)
Sale of equity and debt instruments	320,977	224,014
Investment income received	5,324	3,092
Net cash outflow from investing activities	**(28,165)**	**(15,387)**
Capital contribution	959	25,500
Cash flows from financial activities	**959**	**25,500**
Net increase / (decrease) in cash and cash equivalents	3,156	(3,623)
Cash at bank and in hand at beginning of year	12,766	16,389
Cash at bank and in hand at end of year	**15,922**	**12,766**

The notes on pages 18 to 42 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 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 UK and Republic of Ireland*" ("FRS 102"), Financial Reporting Standard 103, "*Insurance Contracts*" (FRS 103), *The Insurance Accounts Directive (Lloyd's Syndicate and Aggregate Accounts) Regulations 2008* 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.

3 Significant Accounting Policies

The principle accounting policies applied in the preparation of these financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

(a) Basis of preparation

These financial statements are prepared on a going concern basis, under the historical cost convention, as modified by the revaluation of certain financial assets and liabilities measured at fair value through profit and loss.

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 5.

(b) Going Concern

The Directors of the managing agent 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.

(c) Foreign Currency

(i) Functional and presentation currency

The Syndicate's functional and reporting currency is pounds sterling.

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

(ii) Foreign currency

The results and financial positions of the non-functional currencies are retranslated into the functional 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.

Notes to the Financial Statements *(continued)*

3 Significant Accounting Policies *(continued)*

(d) 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 mostly on a time apportionment basis. In the opinion of the Directors of the managing agent the resulting earned proportion is not materially different from one based on the pattern of incidence of risk. For lines of business where the earned proportion would be materially different a pattern based on incident of risk is applied.

Outwards Reinsurance

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.

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 of the managing agent 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.

Notes to the Financial Statements (continued)

3 Significant Accounting Policies (continued)

(d) Insurance Contracts (continued)

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 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.

(iii) Reinsurance assets and liabilities

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 of 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.

Notes to the Financial Statements *(continued)*

3 Significant Accounting Policies (continued)

(d) Insurance Contracts *(continued)*

(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 mostly a time apportionment basis. For lines of business where using a time apportionment basis would lead to a materially different result to applying a pattern based on incident of risk, the risk-based earning pattern is applied.

(e) Financial Instruments

The Syndicate has accounted for financial instruments using Sections 11 and 12 of FRS 102.

(i) *Financial assets*

Basic financial assets, including loans, trade receivables and cash and cash equivalents, are initially recognised at transaction price, unless the arrangement constitutes a financing transaction, where the transaction is measured at the present value of the future receipts discounted at market rate of interest.

Loans and receivables and cash and cash equivalents are initially recognised on the date that they are originated. All other basic financial assets are recognised initially on the trade date at which the Syndicate becomes a party to the contractual provisions of the instrument.

Basic financial assets are recognised initially at cost and subsequently measured at amortised cost.

At the end of each reporting period the Syndicate's basic financial assets are assessed for objective evidence of impairment. If an asset is impaired the impairment loss is the difference between the carrying amount and the present value of the estimated cash flows discounted at the assets' original effective interest rate. The impairment loss is recognised in profit or loss.

If there is a decrease in the impairment loss arising from an event occurring after the impairment was recognised, the impairment is reversed and the reversal recognised in the profit or loss.

The Syndicate's investments in debt securities are classified as fair value through profit and loss financial assets. These are initially recognised at fair value, which is normally the transaction price. 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.

Notes to the Financial Statements *(continued)*

3 Significant Accounting Policies (continued)

(e) Financial Instruments *(continued)*

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.

(ii) *Financial Liabilities*

Financial liabilities, including trade and other payables, bank loans, and loans from fellow group companies are recognised initially at transaction price on the trade date at which the Syndicate becomes a party to the contractual provisions of the instrument.

Subsequent measurement is at amortised cost, using the effective interest rate method.

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

(iii) *Offsetting*

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.

(f) 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.

(g) Taxation

Under Schedule 19 of the Finance Act 1993, managing agents at Lloyd's 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.

4 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.

Notes to the Financial Statements *(continued)*

4 Management of Risk (continued)

(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, which is reviewed through quarterly underwriting meetings, 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. Additionally, the Syndicate regularly monitors its exposure to man-made realistic disaster scenarios.

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.

Notes to the Financial Statements *(continued)*

4 Management of Risk *(continued)*

(b) Insurance Risk *(continued)*

The Syndicate's largest exposures to natural catastrophe 1 in 250 year stress events, gross and net basis at December 2019 are:

Territory	Peril	Gross £m	Net £m
Caribbean	Windstorm	70.0	39.3
United States	Windstorm	21.6	17.4
United States	Earthquake	17.0	14.1
Australia	Earthquake	20.5	9.9
Caribbean	Earthquake	17.3	9.8
Japan	Earthquake	18.7	9.4
Canada	Earthquake	12.1	9.4
Mexico	Windstorm	11.9	7.6
New Zealand	Earthquake	15.2	6.4
Europe	Earthquake	8.2	6.4

In common with all insurers, the Syndicate is exposed to price volatility. However, the Syndicate is firm in its resolve to exit 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.

(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.

Notes to the Financial Statements *(continued)*

4 Management of Risk *(continued)*

(b) Insurance Risk *(continued)*

	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
2019 Impact on profit after tax and equity						
Gross of Reinsurance	(16,156)	16,156	(383)	383	(9,026)	9,026
Net of Reinsurance	(11,781)	11,781	(383)	383	(6,337)	6,337
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

(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 a per risk and per event basis. In 2019, 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.

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.

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.

Notes to the Financial Statements *(continued)*

4 Management of Risk *(continued)*

(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; inadequate performance and or failure of escalation to management; and data protection breach or loss.
Processes	Inappropriate underwriting; inappropriate claims and reserve handling; inappropriate reinsurance purchasing; inadequate performance or 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 inadequate performance or failure; inadequate virus protection; inadequate system or security information; insufficient or untested business continuity processes; insufficient processing capacity; system breach defects; 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	Inadequate performance or failure of an outsourced service provider, including breach of agreement.
Financial crime, including Anti-Money Laundering	Internal or external fraud; electronic crime; money laundering; terrorist financing; bribery and corruption; market abuse; and insider dealing.
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.

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.

Notes to the Financial Statements *(continued)*

(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.

(i) Interest Rate shift in basis Points

Interest rate risk	**2019**	**2018**
	£000	**£000**
Impact of 50 basis point increase on result	(2,435)	(2,482)
Impact of 50 basis point decrease on result	1,656	2,220
Impact of 50 basis point increase on net assets	(2,435)	(2,482)
Impact of 50 basis point decrease on net assets	1,656	2,220

(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 4 (g) 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.

Notes to the Financial Statements *(continued)*

4 Management of Risk *(continued)*

(f) Credit Risk *(continued)*

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.

(i) Credit distribution of invested assets and cash

Standard & Poor's	2019 £m	2019 %	2018 £m	2018 %
AAA	96.7	31.9	86.7	30.3
AA	112.3	37.1	115.6	40.5
A	71.4	23.5	54.2	19.0
BBB	3.9	1.3	4.0	1.4
BBB or less	6.1	2.0	3.2	1.1
Not rated	12.7	4.2	22.1	7.7
Total	**303.1**	**100.0**	**285.8**	**100.0**

Credit distribution of reinsurance receivables

A.M. Best	2019 £m	2019 %	2018 £m	2018 %
A++	-	-	-	-
A+	66.7	72.2	68.3	73.5
A	25.6	27.7	24.5	26.4
A-	-	-	-	-
NR	0.1	0.1	0.1	0.1
Total	**92.4**	**100.0**	**92.9**	**100.0**

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

(ii) 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
2019							
Shares and other variable-yield securities and unit trusts	42,203	-	-	-	-	-	42,203
Debt securities	177,876	-	-	-	-	-	177,876
Participation in investment pools	7,005	-	-	-	-	-	7,005
Overseas deposits as investments	60,158	-	-	-	-	-	60,158
Reinsurers' share of claims outstanding	87,500	-	-	-	-	-	87,500
Reinsurance debtors	4,896	-	-	-	-	-	4,896
Insurance debtors	41,556	5,493	3,625	1,096	821	-	52,591
Other debtors	66,915	-	-	-	-	-	66,915
Cash at bank and in hand	15,922	-	-	-	-	-	15,922
Total credit risk	**504,031**	**5,493**	**3,625**	**1,096**	**821**	-	**515,066**

Notes to the Financial Statements *(continued)*

4 Management of Risk *(continued)*

(g) Liquidity Risk

	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
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**

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.

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.

Notes to the Financial Statements *(continued)*

4 Management of Risk *(continued)*

(g) Liquidity Risk *(continued)*

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	USD	EUR	CAD	AUD	JPY	OTH	Total
	£000	£000	£000	£000	£000	£000	£000	£000
2019								
Financial investments	80,284	72,024	55,768	18,160	-	410	438	227,084
Overseas Deposits	-	659	-	3,072	48,533	-	7,894	60,158
Insurance and reinsurance receivables	4,483	15,810	19,238	1,475	11,737	765	3,979	57,487
Reinsurers' share of technical provisions	8,910	31,419	38,233	2,931	23,326	1,520	7,908	114,247
Cash at bank and in hand	5,499	2,901	5,280	-	1,750	-	492	15,922
Other assets	22,374	8,141	4,308	-	5,345	-	-	40,168
Total assets	**121,550**	**130,954**	**122,827**	**25,638**	**90,691**	**2,695**	**20,711**	**515,066**
Technical provisions	(30,128)	(106,223)	(129,258)	(9,908)	(78,859)	(5,138)	(26,737)	(386,251)
Insurance and reinsurance payables	(1,314)	(4,634)	(5,638)	(432)	(3,440)	(224)	(1,166)	(16,848)
Other creditors	5,913	(13,235)	(693)	-	(512)	-	-	(8,527)
Total liabilities	**(25,529)**	**(124,092)**	**(135,589)**	**(10,340)**	**(82,811)**	**(5,362)**	**(27,903)**	**(411,626)**

	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)**

Notes to the Financial Statements *(continued)*

4 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% increase	£000	+10% increase	-10% increase	£000	+10% increase	-10% increase
Net assets/(liabilities) at 31 December 2019	(12,762)	(1,276)	1,276	6,862	686	(686)	7,880	788	(788)
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)

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 28) 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.

In addition, the Company monitors all key counterparties, including exposures to banking counterparties, on an ongoing basis.

(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)*

4 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)*

4 Management of Risk *(continued)*

(l) Capital Risk *(continued)*

Provision of capital by the member

The 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 member's 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.

5 Critical accounting judgements and estimation uncertainty

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.

(i) 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.

(ii) 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.

Notes to the Financial Statements *(continued)*

5 Critical accounting judgements and estimation uncertainty *(continued)*

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.

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.

(iii) Premium Accruals

Where bordereaux for binders are not received on a timely basis, premium accruals are created by the underwriting teams on a quarterly basis. The accruals are based on a combination of assessment of previous premium bookings and consultation with the delegated underwriting authorities. Accruals are monitored on an ongoing basis by the underwriting teams and finance.

Notes to the Financial Statements *(continued)*

6 Segmental Information

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

	Gross Premiums Written 2019 £000	Gross Premiums Earned 2019 £000	Gross Claims Incurred 2019 £000	Gross Operating Expenses 2019 £000	Ceded Balance 2019 £000	Total 2019 £000
Direct Insurance						
Accident & health	20,015	23,886	(14,590)	(8,982)	(90)	224
Marine	55,246	52,053	(31,692)	(18,320)	(5,137)	(3,096)
Fire & other damage to property	52,305	50,532	(11,904)	(17,595)	(8,637)	12,396
Third party liability	95,921	95,049	(51,302)	(32,167)	(6,123)	5,457
Direct Total	**223,487**	**221,520**	**(109,488)**	**(77,064)**	**(19,987)**	**14,981**
Reinsurance						
Accident & health	412	393	(307)	(77)	1	10
Reinsurance Total	412	393	(307)	(77)	1	10
Total	223,899	221,913	(109,795)	(77,141)	(19,986)	14,991

	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)	293
Reinsurance Total	309	361	-	(34)	(33)	293
Total	232,004	229,600	(128,905)	(85,921)	(10,795)	3,978

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

7 Operating Expenses

Within gross operating expenses are included commissions for direct insurance of £49.0m in 2019 (2018: £54.8m).

	2019 £000	2018 £000
Acquisition costs	(57,978)	(63,500)
Change in deferred acquisition costs	(448)	(835)
Administrative expenses	(18,715)	(21,586)
Reinsurance commissions and profit participation	17,207	16,606
	(59,934)	**(69,315)**

Notes to the Financial Statements *(continued)*

7 Operating Expenses *(continued)*

Administrative expenses include:

	2019 £000	2018 £000
Fees payable to the Syndicate's auditors and their associates for the audit of the Syndicate's annual accounts	(118)	(88)
Audit services pursuant to regulation	(155)	(148)
Other Services	-	(12)
Total	**(273)**	**(248)**

8 Investment Income

	2019 £000	2018 £000
Interest and similar income		
From financial instruments designated as at fair value through profit or loss	3,572	3,026
From investments designated as at fair value through profit or loss		
Net gain / (loss) on realisation of investments	1,504	(869)
Unrealised gains / (losses) on investments	491	(81)
Total Investment income	**5,567**	**2,076**

9 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:

	2019 £000	2018 £000
Directors of the Managing Agent	1,012	794
Active Underwriter	212	250

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:

	2019	2018
Underwriting	34	35
Administration and finance	51	40
Claims	9	12
	94	**87**

Notes to the Financial Statements *(continued)*

9 Directors' Remuneration and Employee Costs *(continued)*

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

	2019	2018
	£000	£000
Salaries	7,380	8,536
Social security costs	838	909
Other pension costs	655	682
	8,873	**10,127**

10 Other Debtors and Creditors

	2019	2018
	£000	£000
Amounts due from associated undertakings	9,599	16,704
Amounts due to associated undertakings	(1,999)	(6,073)
	7,600	**10,631**

11 Other Assets

	2019	2018
	£000	£000
Claims Funds	10,359	7,722
	10,359	**7,722**

12 Accruals and Deferred Income

	2019	2018
	£000	£000
Deferred ceding commissions	6,528	6,549
	6,528	**6,549**

Notes to the Financial Statements *(continued)*

13 Financial Investments

	Fair Value 2019 £000	Cost 2019 £000	Fair Value 2018 £000	Cost 2018 £000
Shares and other variable-yield securities				
Short term & cash equivalents	36,544	36,544	32,423	32,424
Other investments	5,659	5,659	2,762	2,767
	42,203	**42,203**	**35,185**	**35,191**
Debt securities and other fixed-income securities				
Sovereign & government agency	165,312	168,590	140,767	141,400
Corporate bonds	12,564	12,694	17,191	16,790
Collective Investments Undertakings	7,005	7,007	-	-
Other investments	-	-	7,685	7,542
	184,881	**188,291**	**165,643**	**165,732**

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.

The fair values above were determined using the fair value hierarchy as defined in Note 3 (e) (i). The split by level is:

As at 31 December 2019

	Level 1 £000	Level 2 £000	Level 3 £000
Other variable-yield securities	-	41,608	595
Debt securities and other fixed-income securities	36,601	141,275	-
Participation in investment pools	7,005	-	-
Overseas Deposits	2,533	57,625	-
	46,139	**240,508**	**595**

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**	-

Notes to the Financial Statements *(continued)*

14 Technical Provisions

(a) Summary of net technical provisions:

	Gross 2019 £000	Ceded 2019 £000	Net 2019 £000	Gross 2018 £000	Ceded 2018 £000	Net 2018 £000
Notified claims	127,670	(33,722)	93,948	138,040	(41,303)	96,737
IBNR (incl ULAE)	180,516	(53,778)	126,738	172,891	(51,635)	121,256
Unearned Premium	78,065	(26,747)	51,318	78,863	(22,603)	56,260
Total	**386,251**	**(114,247)**	**272,004**	**389,794**	**(115,541)**	**274,253**

(b) Reconciliation of claims technical provisions:

	2019 £000	2018 £000
Net claims technical provisions brought forward		
Outstanding claims	96,737	83,834
IBNR claims	121,257	129,562
	217,994	**213,396**
Losses incurred in the year		
Current accident year	91,828	105,552
Prior accident years	(6,581)	(8,546)
	85,247	**97,006**
Paid losses		
Current accident year	(11,736)	(7,784)
Prior accident years	(62,425)	(85,954)
	(74,161)	**(93,738)**
Foreign exchange differences	(8,394)	1,329
Net claims technical provisions carried forward		
Outstanding claims	93,948	96,737
IBNR claims	126,738	121,257
	220,686	**217,994**

Notes to the Financial Statements *(continued)*

14 Technical Provisions *(continued)*

(c) Gross claims development triangles – by underwriting year

Underlying Pure Year	At end of u/w year	One year later	Two years later	Three years later	Four years later	Five years later	Six years later	Seven years later	Eight years later	Cumulative payments	Outstanding reserves
	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000
2011	39,993	108,790	115,138	111,851	107,900	109,319	108,887	107,946	107,979	98,522	9,457
2012	38,222	79,003	72,919	72,738	72,073	69,029	69,694	65,889		51,489	14,400
2013	54,436	107,811	113,091	115,472	110,047	102,658	98,927			87,261	11,666
2014	40,844	93,602	106,494	106,744	113,710	111,202				91,605	19,597
2015	39,643	103,126	115,987	116,291	112,403					83,944	28,459
2016	41,933	116,315	126,557	124,873						77,348	47,525
2017	63,487	133,268	146,393							87,774	58,619
2018	45,448	107,400								37,384	70,016
2019	48,185									3,291	44,894
Total	412,191	849,315	796,579	647,969	516,133	392,208	277,508	173,835	107,979	618,618	304,633

	Cumulative payments	Outstanding reserves
2010 & Prior	79,469	3,553
Total	**698,087**	**308,186**

(d) Net claims development triangles – by underwriting year

Underlying Pure Year	At end of u/w year	One year later	Two years later	Three years later	Four years later	Five years later	Six years later	Seven years later	Eight years later	Cumulative payments	Outstanding reserves
	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000
2011	27,974	74,780	75,882	72,628	72,318	73,492	72,555	72,426	72,514	66,568	5,946
2012	28,039	62,471	58,120	58,423	58,230	57,136	56,247	53,186		43,525	9,661
2013	38,840	74,465	77,764	80,196	76,844	72,051	70,098			61,206	8,892
2014	30,382	68,611	78,669	80,133	83,263	82,508				68,559	13,949
2015	29,375	77,813	88,989	90,176	86,986					66,176	20,810
2016	31,320	90,242	99,469	99,366						61,733	37,633
2017	42,898	100,515	113,214							70,590	42,624
2018	29,141	75,272								29,298	45,974
2019	34,614									2,951	31,663
Total	292,583	624,169	592,107	480,922	377,641	285,187	198,900	125,612	72,514	470,606	217,152

	Cumulative payments	Outstanding reserves
2010 & Prior	66,638	3,533
Total	**537,244**	**220,685**

Notes to the Financial Statements *(continued)*

14 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 2019	Ceded 2019	Net 2019	Gross 2018	Ceded 2018	Net 2018
	£000	£000	£000	£000	£000	£000
At 1 January	310,931	(92,938)	217,993	296,828	(83,432)	213,396
Movement per technical account	9,527	1,559	11,086	11,052	(7,784)	3,268
Exchange rate impact	(12,272)	3,879	(8,393)	3,051	(1,722)	1,329
31 December	**308,186**	**(87,500)**	**220,686**	**310,931**	**(92,938)**	**217,993**

Unearned Premiums

	Gross 2019 £000	Ceded 2019 £000	Net 2019 £000	Gross 2018 £000	Ceded 2018 £000	Net 2018 £000
At 1 January	78,863	(22,603)	56,260	74,724	(19,491)	55,233
Movement per technical account	1,983	(4,724)	(2,741)	2,404	(2,642)	(238)
Exchange Rate Impact	(2,781)	580	(2,201)	1,735	(470)	1,265
31 December	**78,065**	**(26,747)**	**51,318**	**78,863**	**(22,603)**	**56,260**

15 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 (2018: £117.8m) are provided by Arch Reinsurance Ltd on behalf of Arch Syndicate Investments Ltd, and hence do not form part of these financial statements.

The remaining element of the FAL requirement amounts to £118.1m (2018: £124.8m) 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 contributions from Arch Reinsurance Ltd in 2019 totalling £0.9m (2018: £25.5m) to support the 2020 business plan.

16 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 HM 08, Bermuda.

Notes to the Financial Statements *(continued)*

16 Related Parties *(continued)*

Arch Reinsurance Ltd.

Syndicate 2012 has a whole account quota share reinsurance contract of 15.0% (2018: 15.0%) with Arch Reinsurance Ltd. The Syndicate ceded £28.3m (2018: £30.0m) of net written premiums during the 2019 financial year. The effect of the quota share contract reduced net underwriting losses by £1.4m (2018 reduced by £0.8m) in the 2019 financial year.

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

AUAL is the Managing Agent of Syndicate 2012. During 2019 the Syndicate paid the Managing Agent £415,000 (2018: £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 2019 AUALA has bound £28.3m (2018: £23.3m) of gross written premiums on behalf of Syndicate 2012. The Syndicate has incurred a net profit of £1.0m (2018: profit £0.5m) on the business bound by the service company for the year ended 31 December 2019.

Arch Syndicate Investments Ltd

The Syndicate is supported by Arch Syndicate Investments Ltd, which provides 100.0% of its underwriting capacity, see note 15 Funds at Lloyd's.

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 2019 AUAAPL has bound £nil (2018: £nil) of gross written premiums on behalf of Syndicate 2012. The gross written premiums in 2019 are aggregated within the AUALA bound premiums and therefore form part of the £28.3m. (2018: 23.3m).

Axiom Underwriting Agency Limited ("Axiom")

The Managing Agent owns 100.0% of Axiom which is authorised to bind business on behalf of Syndicate 2012. During 2019, Axiom has bound £0.6m (2018: £1.3 m) of gross written premiums on behalf of the Syndicate.

Directors of the Managing Agent and Administration

Directors of the Managing Agent as at 5th March 2020

S. Bashford
N. Denniston
J. Kittinger
P. Leoni
P. Martin
J. Mentz
P. Storey
H. Sturgess

Syndicate Secretary

TMF Corporate Administration Services Limited

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