TOKIO MARINE
HCC

HCC International Insurance Company plc

Annual report and consolidated financial statements

Year ended 31 December 2018

HCC International Insurance Company plc
Annual Report and Accounts

Year ended 31 December 2018

Underwriting Vision Unrivalled Value

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Business Structure

HCC International Insurance Company plc ('HCCII') and its subsidiaries (the 'Group') are part of the Tokio Marine Group ('TM Group'), whose ultimate holding company is Tokio Marine Holdings, Inc. TM Group is a leading international insurance group located in Tokyo, Japan which has 249 subsidiaries, and 22 affiliates worldwide. TM Group undertakes non-life and life insurance and operates within the financial and general business sector (including consulting and real estate).

As of 31 December 2018, TM Group had total assets of ¥23.3 trillion (December 2017: ¥23.3 trillion) and shareholders' equity of ¥3.5 trillion (December 2017: ¥3.9 trillion). TM Group and a number of its major insurance companies have a financial strength rating of A+ (Stable) from Standard & Poor's Financial Services LLC (S&P).

HCC Insurance Holdings, Inc. (TMHCC Group) is a subsidiary within the TM Group based in the United States and is a leading international specialty insurance group with more than 100 classes of specialty insurance, underwriting risks located in approximately 180 countries. Given its financial strength and track record of excellent results, it benefits from an S&P rating of AA-.

TMHCC International is TMHCC Group's operating segment outside of the United States. Located in the United Kingdom and Continental Europe, TMHCC International underwrites business on four different insurance platforms: HCCII (a UK insurance company), its wholly owned subsidiary Tokio Marine Europe S.A. (TME), (a Luxembourg company), HCC Syndicate 4141 (a wholly aligned Lloyd's syndicate) and Houston Casualty Company (London Branch). HCCII and TME have standalone S&P ratings of AA-. The platform used is based on prescribed rules and if licensing permits, client choice. For the year-ended 31 December 2018, TMHCC International had Gross Written Premiums (GWP) of $846.6m (2017: $666.9m).

Historically, and through 2018, HCCII conducted business through its principal offices in London and its regional offices across the UK. European business was underwritten through its branches in Spain, Ireland, France, Switzerland, Germany, Italy and Norway. This has changed from 1 January 2019 as a result of the new regulatory landscape brought about by Brexit.

During 2018, the Group structure expanded with the formation of a new European insurance company, TME and the acquisition of the underwriting agency Qdos Holdings Limited (QHL).

TME

The United Kingdom's vote to leave the European Union (EU) in June 2016 and the subsequent triggering of Article 50 on 29 March 2017 presented the TM Group with the risk that HCCII and its UK affiliate, Tokio Marine Kiln Insurance Company Limited (TMKI), would, upon the UK's exit from the EU, no longer be licensed to write the European business historically underwritten on a freedom of services basis through their respective European branches and in the UK.

To mitigate this risk, in February 2018 HCCII established a new subsidiary TME based in Luxembourg utilising already existing excess capital of $100m which in December 2018 increased to $120m. TME received authorisation from the Luxembourg insurance regulator in April 2018. Throughout 2018, TME successfully established European branches in Spain, France, Italy, Norway, Denmark, Netherlands, Ireland, Belgium, Germany and the UK. TME commenced underwriting new and renewal business on 1 January 2019. In 2018, HCCII, TMKI and TME also began the legal Part VII transfer process to move the existing insurance and reinsurance contracts that had historically been underwritten by HCCII and TMKI European branches and all branch employees to TME. The transfer was affected through TME issuing one share each, first to TMKI and then to HCCII. The effective date of the Part VII transfer was 1 January 2019. Further details of the Part VII transaction, included as a subsequent events disclosure, are contained in Note 25.

Given the establishment of TME, a European insurance company that is within the European market, the directors believe that HCCII has mitigated the risk that subsequent to the UK's exit from the EU, HCCII would no longer have the requisite licences to write business across all European member states.

QHL

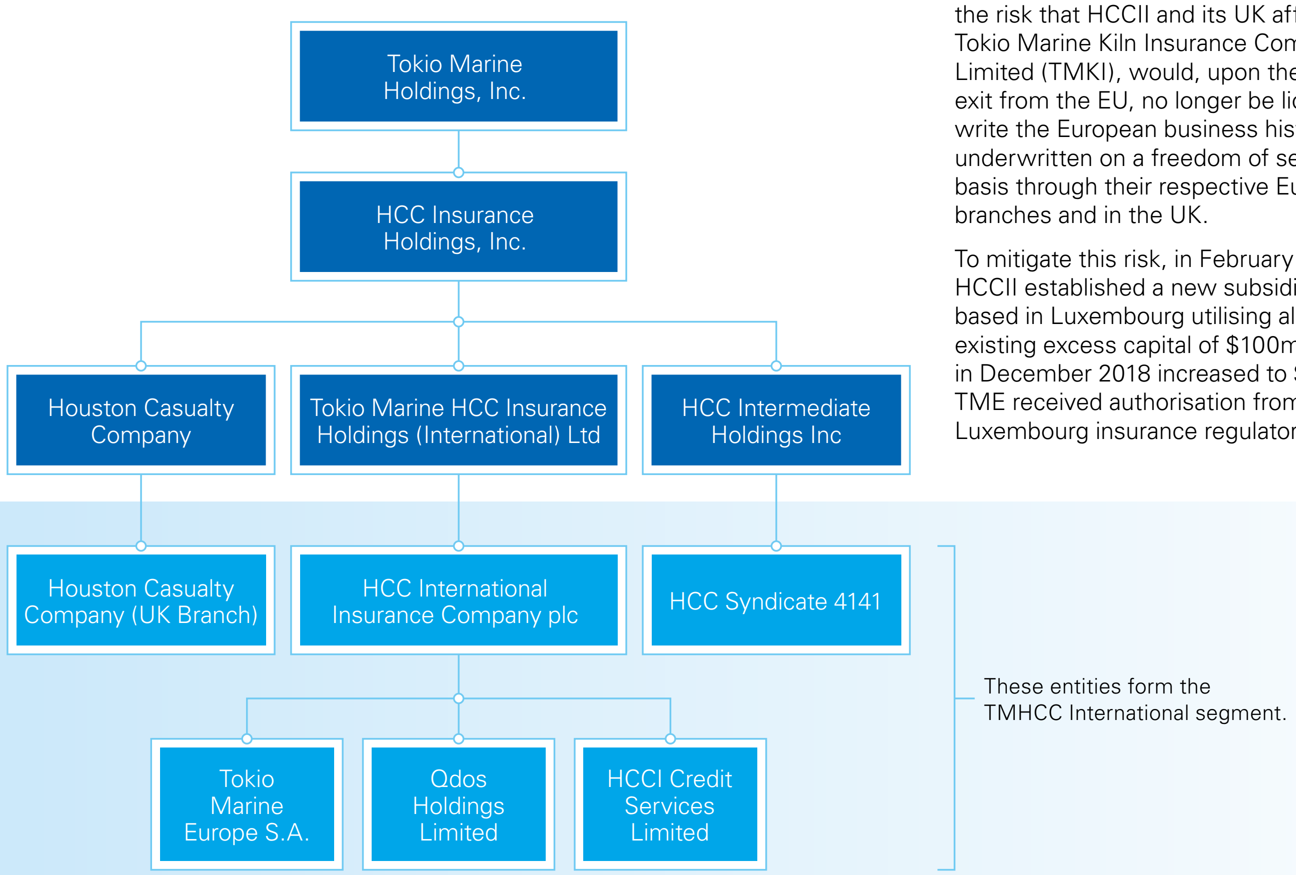
In October 2018 HCCII acquired QHL, an underwriting agency based in the UK with whom it has had a long-standing relationship. QHL has a wholly owned subsidiary, Qdos Broker and Underwriting Services Limited (QBuS), which distributes Professional Indemnity (PI), Employers Liability and Public Liability (ELPL) and Tax Enquiry and Liability (TEL) insurance to the UK small contractor market via Qdos Shop, an online digital distribution platform. The business produced by QBus has historically been very desirable and the Directors believe that this strategic acquisition will give the Group a platform and a direct brand to further grow its Professional Risks businesses.

At 31 December 2018 the Group now includes the following principal subsidiaries: TME, QHL and HCCI Credit Services Limited (Credit Services). Credit Services provides data and information services to the credit insurance market. The results of the Group are included within these consolidated financial statements for the years ended 31 December 2018 and 2017.

In addition to the strategic investments above, the Group continues to expand its underwriting teams, most notably the hiring of European Surety underwriters who are located in the TME branches and offices located throughout Europe.

The Group has also hired a Marine Liability team who are recognised as market leaders in this class to develop this line of business, increasing the Group's Marine product offering.

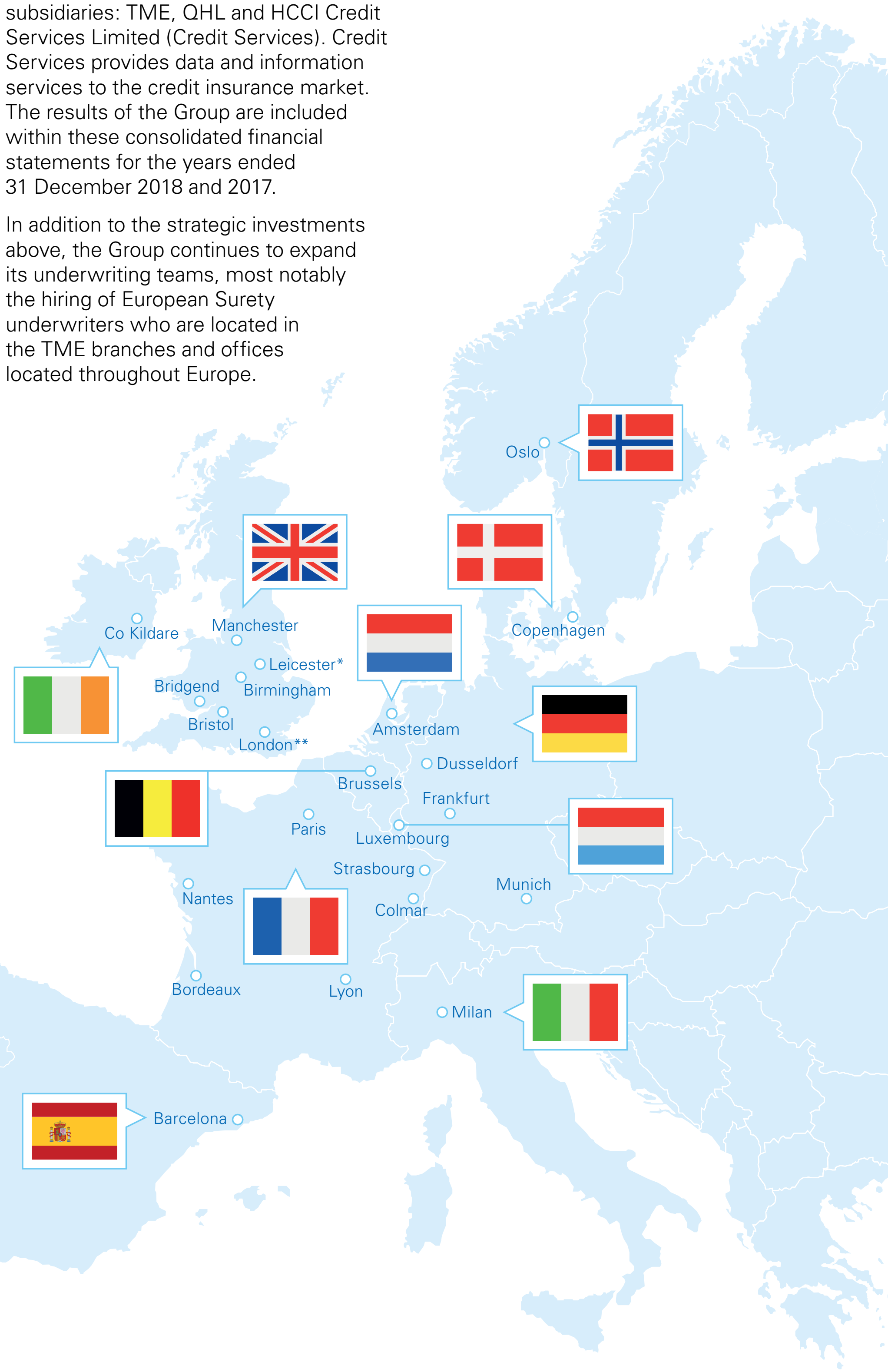
The Group is well capitalised and HCCII continues to be the flagship entity of the TMHCC International segment with a standalone S&P rating of AA-.



Information as at 1 March 2019. This simplified structure chart shows ownership information for the principal operating entities within the TMHCC International segment.

Geographical footprint

The map illustrates the locations of the Group's branches and offices throughout Europe



* 2 offices
** 3 offices

Strategic Report continued

Business Model

The Group's business model is built upon fundamental principles which position policyholders with confidence about their risk decisions. Specifically, focused underwriting expertise combined with a good distribution network and a strong capital base enables the Group to provide the right solutions to clients. Skillful and sustainable reinsurance purchasing, careful investment of premium, conservative reserving and fair claims handling provides the Group with a solid foundation upon which to apply the TM Group's 'Good Company' approach to business.

Face risk with confidence

In 2018 the Group had two core underwriting segments; International Specialty and London Market.

The International Specialty lines of business are comprised of:

- Financial Lines;
- Professional Risks (including Contingency business);
- Credit & Political Risk; and
- Surety.

The London Market division includes the following lines of business:

- Marine & Energy;
- Property Treaty;
- Property Direct and Facultative; and Accident & Health (A&H).

The Group writes London Market and International Specialty products from its UK offices, its European branches and across the rest of the EEA via Freedom of Services authorisations and accepts inwards reinsurance risks from United States, Canada, Australia and the rest of the world where its licenses permit. Apart from some small Personal lines contracts written within A&H, Marine and Professional Risks businesses, all other business written by the Group is Commercial lines.

From 1 January 2019, following the creation of TME and the Part VII transfer of business and employees from TMKI's European branches to TME, the Group will add a new sub segment (European Property & Casualty (P&C)) which is principally focused on the support of large Japanese clients. The sub segment will continue to provide service focused insurance solutions principally to Japanese corporate interests throughout the EEA.

Face risk with confidence

Protecting our customers from risk, and allowing them to take on opportunity with confidence

Providing clients with the right solutions

Through our distribution network

Providing clients with products through the distribution network

The International Specialty and London Market products underwritten by the Group are distributed to clients through established broker (wholesale, regional and specialty), underwriting agency and coverholder relationships. Additionally, Credit, Surety and Professional Risks business is written through online distribution portals.

Underwrite and manage risk

Disciplined underwriting, careful risk selection and resinsurance purchasing

Underwriting and managing risk

Central to the Group's culture is the strategy of underwriting profitable business through careful risk selection and reinsurance purchasing, in order to preserve shareholder's equity and to meet its targeted risk adjusted return. To ensure risks are correctly priced, the Group's experienced and technical underwriters underwrite each risk individually, assessing a range of factors including but not limited to: financial exposure, loss history, risk characteristics, limits, deductibles, terms and conditions and acquisition expenses using rating and other models. For certain areas (which are limited in scope) where distribution is held by coverholders or brokers, the Group does delegate underwriting, however this is undertaken through standard rating sheets and referral controls for risks that require non-standard pricing.

Claims management

Treating customers fairly, timely processing and settling of claims

Claims management

The Group understands the importance of the claims settlement process to its clients and its approach to the management and settlement of its claims provides a key opportunity for the Group to differentiate itself from its competitors. The claims teams are focused on delivering high quality, reliable and efficient claims service by adjusting and processing claims fairly and in a timely manner; in accordance with the policy's terms and conditions; and the conduct rules.

Investment

Preserve and grow shareholder's equity through conservative investment

Investment

The Group has a conservative investment strategy that aims to preserve and grow shareholder's equity and to maximise net investment income. To achieve this investment strategy, funds are invested in accordance with the Solvency II risk-based approach to investments and the 'prudent person principle', which ensures that assets are of appropriate security, quality and liquidity; are adequately diversified; and broadly match its liabilities.

Reserves

Accurate, reliable and consistent reserves with S&P rating of AA-

Reserves

The Group's reserving policy safeguards reliable and consistent reserve estimates across all classes of business, maintaining overall reserves at, or above, the actuarial midpoint. The reserving process is embedded into the governance framework which requires that an internal and robust review of reserves is carried out at least quarterly, together with annual independent assurance.

Strategic Report continued

Strategy

The Group's fundamental business philosophy is to produce an underwriting profit and investment income resulting in consistent net earnings which will increase shareholder value. In order to achieve this the Group's strategy is centred on selective and focused management of a diversified portfolio of businesses; continued expansion of its brand with presence in the UK regional market, the London Market and throughout the rest of Europe; identification and development of opportunities to grow its business; and maintenance of the management, organisational and governance structure which is appropriate for and supports the Group's growing business.

The Group has consistently delivered its strategic plan because of the following key strengths:

- **Diversified portfolio of specialty business** – A balanced portfolio is achieved by writing a spread of business over time, segmented between different products, geographies and sizes; and differentiating itself from competitors either in product offering, customer service or market positioning. This results in a diverse and balanced portfolio of risks across lines of business which limits volatility and enables the Group to consistently achieve an underwriting profit.
- **Operational efficiency** – the TMHCC International segment manages portfolios by line of business on a single integrated operating model. This provides operational efficiencies across the TMHCC International segment.
- **Skilled and entrepreneurial management** – the Group has a flat operational structure with an experienced and entrepreneurial management team. This enables flexible adaptation to the changing business environment, resulting in faster decision making and responsiveness to opportunities.
- **Prudent risk management** – the Group's conservative risk appetite and approach to risk management ensures that risks are identified, monitored and mitigated. Reinsurance is one of the most important risk mitigation tools used to limit exposure, reduce the volatility of various lines of business and preserve capital.
- **Financial security** – the Group has very strong security (HCCII and TME both have S&P Ratings of AA-). This provides the policyholder with the knowledge and comfort that their insurer will be able to honour its obligations when called upon to do so. Financial strength is a key differentiator for the Credit, Surety and Financial Lines businesses and allows the Group to access the highest quality risks where an insurer's financial strength carries a premium.

Generating Value

The Group shares the TM Group's **'Good Company'** vision, and the core principles of this vision guides how the Group creates sustainable value for all its stakeholders: customers, employees, distribution network, suppliers, shareholders and the community.

To deliver its strategy the Group relies on the following key resources and relationships to support the generation and preservation of value throughout all aspects of its business model.

- **Technology** – the Group has technology solutions which generate value throughout its business. These include: catastrophe modelling and aggregation tools; e-distribution portals for our Credit, Surety and Professional Risks (including Contingency) lines of business; capital modelling tools; policy and claims administration; reinsurance calculation; and IT security software to increase its IT resilience. These solutions provide increased operational efficiencies which benefit the Group's employees, distribution network and customers.
- **Stakeholders** – strong stakeholder relationships are important, including: clients, distribution network, shareholder, regulators and suppliers. The Group's relationships with its stakeholders are vital to its ongoing success. The actions it takes in respect of those stakeholder relationships are detailed on pages 8-11.
- **Employees and intellectual capital** – the knowledge, skills and expertise of the Group's employees are as diverse as the risks it writes. This ensures that it has the right mix of expertise to support its business model and to continue to deliver strong and consistent performance. The actions taken by the Group to manage, sustain and develop its employees are detailed in the Business conduct and ethics on pages 10 and 11.
- **Financial capital** – the Group has a strong balance sheet; its capital is well in excess of regulatory requirements and HCCII and TME both have a financial strength rating of AA- from S&P. The Group's financial performance (detailed in the Business Performance section on pages 17-19) consistently generates value for its shareholder.

Flexible Thinking Generating Value

Strategic Report continued

Business Environment

Corporate Social Responsibility (CSR)

The Group strives to be a 'Good Company' and has a long-term commitment to make a positive impact for employees, customers, local communities and the wider society through acts of solidarity and promotion of opportunity.

The CSR strategy is founded on four pillars: community, workplace, marketplace and environment and is consistent with the 'Good Company' vision. The strategy is well-developed, and it has been refined over several years to ensure maximum effect.

The strategy positions the Group to:

- recognise and confront the varied challenges presented by modern day society;
- promote equality and diversity;
- deal with stakeholders openly and transparently; and
- reduce its carbon footprint.

Community

During 2018, the Group continued its partnerships with charities in the UK and Spain. The principal partnerships are with smaller local charities where the Group has found that its support can make a real difference to local communities. The Group is committed to helping individuals who have been forced to endure and confront challenges arising from issues such as homelessness and other types of trauma, and in 2018 it also supported charities focused on assisting children with complex needs. In addition to financial contributions by the Group, employees are actively encouraged to take two paid days outside of their holiday allowance to volunteer for causes in their local communities.

Workplace

The Group has always sought to develop its employees, maximise their talents and provide opportunities whilst being cognisant of pressures created by a modern-day workplace. To achieve this, in-house courses covering subjects ranging from leadership to mental well-being are provided to staff. The staff appraisal system is consistently reviewed to ensure that it remains as effective as possible.

Marketplace

Gaining and maintaining policyholder trust within strict conduct risk controls is important. Throughout 2018 we continued to ensure: reviews of all new products were undertaken to ensure added value to the target market; customer advocate reviews of policy wordings; comprehensive due diligence on all third parties with whom we do business prior to engagement and audits undertaken thereafter; allocation of product risk ratings and continual monitoring of the products with the highest risk ratings using detailed management information to ensure fair consumer outcomes; and compliance monitoring of licensing, sanctions, financial crime and treating customers fairly practices. During 2018, the Group continued to monitor the performance of its products to ensure they performed as intended.

Environment

The Group understands both the economic and environmental benefits associated with the implementation of energy efficiency measures. The Group continues to reduce the use of paper, instituting new policies to facilitate this initiative and promote recycling. Other energy saving practices are in operation within the Group's offices and during 2019 the Group will explore additional ways in which it can reduce carbon emission and increase its energy efficiency.

Employees

To attract and retain talent, the Group is committed to providing a work environment that is both challenging and rewarding. One of the key metrics used to measure this is quarterly monitoring of the rate of employee turnover and underlying reasons (this is included within the Non-Financial KPIs on page 12). Timely review of the factors contributing to employee turnover positions enables the Group to take appropriate action to address the factors driving this to ensure it continues to offer its employees a workplace that is both rewarding and challenging.

Employee benefits

The Group offers competitive salaries and benefits that include a contributory company pension scheme, life insurance, permanent health insurance, season ticket loans, as well as employee discounts and benefits (including travel, leisure, health and high street stores) through its Lifestyle benefits scheme.

Health, safety and wellbeing

The physical and mental health, safety and wellbeing of employees is critical.

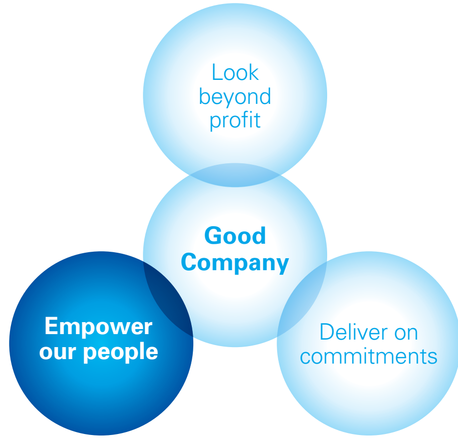
To support its employees the Group provides a range of health and wellbeing benefits and resources, including private medical insurance, gym membership contribution and eye care. There is also an employee assistance programme which provides employees with free and confidential access to professional advice on a range of issues.

The Group is cognisant of the importance of the welfare of its employees and provides workshops to employees on topics such as handling stress and mental health awareness training for managers.

To ensure employees work safely the Group has established health and safety policies. Employee training and a health and safety group that meets regularly.

Training and development

In addition to a competitive salary and benefits, employees receive training and career development support that includes: internal and external courses provided by professional consultants;



external conferences and seminars; and study support. We also have 5 employees on apprenticeship schemes which are funded by our apprenticeship levy (a government scheme under which employers of a certain size are required to contribute to an apprenticeship levy which a company then uses to fund apprenticeships).

Alongside its existing training and development opportunities, TMHCC Group implemented a Leadership Excellence and Development programme (LEaD), which the Group participates in. LEaD is a leadership development programme which supports TMHCC Group's strategic talent management by developing internal talent over a two-year period. Currently the Group has 6 participants in the LEaD programme.

Equality and diversity

The Group is committed to promoting and valuing diversity, providing equal employment opportunities and to avoiding unlawful discrimination in the workplace or against employees, customers, or service providers. The Group's diversity and equal opportunity policy details the standards, expectations and responsibilities its people and the organisation are required to comply with to ensure that everyone, is dealt with in a fair way during the recruiting process and throughout their career with the Group, which includes access to appropriate training and development opportunities or job progression.

Strategic Report continued

Business Conduct and Ethics

The Group is committed to carrying out its business activities fairly, honestly, transparently and in compliance with legal and regulatory requirements, to enhance stakeholder trust. This approach is embedded in the Group's business and governance framework through policies, procedures and compliance monitoring.

TMHCC Group's Code of Business Conduct and Ethics together with the Group's employee handbook, set out how we operate and include reference to specific policies, including: whistleblowing; anti-bribery; conflicts of interest; and treating customers fairly statements. All new employees are provided with e-training modules that cover ethics, anti-bribery and data protection.

Conduct

At the core of the Group's approach to responsible business is a commitment to ensuring that all policyholders receive fair treatment throughout the product lifecycle and no detriment is caused to the Group, its customers, clients or counterparties because of the inappropriate execution of our business activities. This ethos is communicated through our governance structure from the Board to all members of staff, with a specific committee responsible for oversight of conduct, product governance and distribution throughout the business. Conduct risk e-training is also provided to employees working in underwriting, claims, compliance, internal audit, marketing and risk departments and to executive and non- executive directors.

Complaints

The Group is dedicated to ensuring policyholders and claimants receive a high-quality service and aims to ensure that complaints are handled fairly, effectively, promptly and resolved at the earliest opportunity, minimising the number of unresolved complaints which may need to be escalated.

There are effective and transparent procedures in place concerning the handling of complaints which ensure proper investigation and appropriate resolution. The complaints handling procedure outlines the process for the handling of complaints to ensure they are identified and handled in accordance with the Financial Conduct Authority's (FCA) rules.

The Group monitors complaints received on all lines of business using detailed management information to ensure fair consumer outcomes. The management information monitors volume of complaints, complaint outcomes and the outcomes of the Financial Ombudsman Service (FOS) in the event a policyholder disagrees with a decision made by the Group in respect of a complaint and have referred their complaint to the FOS who independently reviews it. These complaint metrics are reported within the non-financial KPIs.

Sanctions

The Group is subject to UK and European sanctions and OFAC-administered US sanctions in territories where it is deemed to be a US Person (Iran, Cuba, and Syria). To ensure the Group avoids writing business with exposure or potential exposure to sanctions targets, the compliance department ensures all employees within the business have sanctions awareness and this is achieved through the provision of e-training for all employees. The Group also runs real-time and batch-screening that is designed to identify possible matches between potential insureds or claimants and listed sanctions targets. The results of these tests are reported as part of the non-financial KPIs.

Licensing

The Group's policy is to seek licensing or registration as an approved (re)insurer where it may not legitimately accept risks on a non-admitted (unlicensed) basis and all applicable (re)insurance licences were renewed in 2018. The compliance team undertake monthly reviews to ensure adherence to licensing requirements, and the results of these reviews are provided as part of the non-financial KPIs.

Anti-bribery and corruption

The Group has zero tolerance for bribery and corruption. The anti-bribery and anti- corruption policies detail definitions of corruption and bribery as well as how to report any cases of suspected wrongdoing.

The Group's gifts and entertainment policy also supports the anti-bribery and corruption policy and provides guidance to employees on the giving, receiving and recording of business gifts and hospitality. In addition, the conflicts of interest policy provides employees with guidance regarding assessing, managing and recording conflicts of interest and employees and Board members are required to complete an annual declaration regarding conflicts of interest.

All business that would expose the Group to any parties domiciled in countries that exhibit a high corruption risk (countries with a score of 20% or less on the Transparency International Corruption Perceptions Index (CPI) require approval from (a member of the executive team) prior to inception and the receipt of approval is monitored by the compliance department. The non-financial KPIs set out the number of instances when the Group sought executive approval during 2018.

Money laundering and financial crime

Any business that would expose the Group to any parties domiciled in countries exhibiting a high money-laundering risk (a risk score of 7.5 or more (out of 10) on the Basel AML Index and countries that are watch-listed by the Financial Action Task Force) requires executive approval prior to inception and the receipt of this approval is monitored by the compliance department.

The Group also has an additional anti-money laundering control in place in order to ensure that policy acquisition and cancellation have not been used as a means of laundering the proceeds of crime. This extra control is undertaken by the compliance department biannually and involves analysis of all returned premiums up to two months after policy inception that are above a certain, line-specific percentage of original premiums. To obtain similar confidence that claims have not been engineered for money laundering, all claims made within seven days of policy inception are similarly analysed by compliance.

During the year the compliance department undertook a Financial Crime Risk Assessment covering the following areas: bribery, corruption, money laundering, financial crime and sanctions. A follow up to the 2018 Financial Crime Risk Assessment will be undertaken in 2019.

The results of the Group's money laundering controls are provided within the non-financial KPIs.

Procurement, outsourcing and working with third parties

The Group's responsible approach to business extends to procurement, outsourcing and third parties and it is committed to preventing slavery and human trafficking in its corporate activities and ensuring that its supply chains and third-party relationships are free from slavery and human trafficking.

The outsourcing and contract management policy; delegated underwriting procedures and intermediary vetting procedures set out the due diligence required and the monitoring processes (including regular audits) that will be undertaken regarding third parties. Transparency in the supply chain in relation to modern slavery and trafficking is reviewed at the due diligence stage. The Group's Modern Slavery Statement can be found on our website.

Whistleblowing

The Group's whistleblowing policy follows accepted best practice and complies with the Prudential Regulation Authority (PRA) and Financial Conduct Authority's (FCA) whistleblowing requirements and whistleblowing e-training has been provided to all employees. It outlines the procedures and processes for when and how to speak up about wrongdoing within the organisation. An individual can raise a concern internally or externally via the PRA, FCA or via an externally provided confidential hotline. The non-executive Chairman of HCCII's audit committee has been appointed as the whistleblowing champion and the audit committee receives regular reports on the whistleblowing arrangements. No whistleblowing concerns were reported through the internal or external channels during 2018.

Data protection

TMHCC Group successfully undertook a significant project to ensure that material compliance with the General Data Protection Regulations (GDPR) was achieved by 25 May 2018, when GDPR rules came into force across Europe. A data protection governance structure has been put in place, and a Group Data Protection Committee has been established. The embedding of GDPR compliance is ongoing, with a programme of continual improvement aided by the recruitment of a dedicated data protection resource in July 2018, and a focus on embedding privacy by design across Europe, the UK and United States. Considerable work was also undertaken during 2018 to assist the data protection compliance efforts of the TMKI branches that became part of TME from 1 January 2019 following the Part VII transfer.

Strategic Report continued

Non-Financial Key Performance Indicators (KPIs)

Non-financial KPIs	Description	2018 Result
Sanctions	Sanctions matches (UK, European and OFAC-administered US sanctions in territories where the Group is deemed to be a US Person).	• No business was written which was subject to sanctions in territories where the Group was deemed to be a US person. • No claims were received that would have exposed the Group to the risk of infringing any sanctions.
Licensing	Policies written in line with licensing restrictions/permissions.	• All polices were written in line with licensing restrictions and permissions.
Bribery and corruption	Executive approval pre-inception for risks where a party is domiciled in countries with a score of <20% on the CPI.	• Approval was sought post inception 7 times in 2018.
Money laundering	Executive approval required pre-inception for risks where a party is domiciled in countries with a score of >7.5 on the Basel AML Index. Return Premiums >15% of the gross premium and >£10,000 (or £1,000 for PI) up to 2 months after inception. Any claims made within 7 days of policy inception.	• Approval was sought post inception 8 times in 2018. • The bi-annual review of returned premiums and claims provided no grounds for the suspicion of money-laundering in 2018.
Volume of complaints	Total number of complaints received.	27
Complaint outcomes	The number of complaints received which have been upheld i.e. where the policyholder's complaint is found to be justified. The number excludes complaints where the Group does not accept any wrongdoing but has made an ex-gratia payment to the insured.	7
Financial Ombudsman Service (FOS) outcomes	% of complaints which have been upheld by the FOS following referral of complaint by an eligible policyholder who disagrees with the Group's final decision.	0%
Employee turnover metric	The number of permanent non-fixed term contract employees, of the HCC Service Company, Inc. (UK branch) and HCC Global Financial Products S.L., who have left over the last 12 months divided by the average number of permanent non-fixed term contract staff over the last 12 months.	(RAG rating: R = turnover is 0% or more than 13%; A = turnover is 1%-3% or 10%-13%; G = otherwise). 8.0% and Green as at 31 December 2018.

Non-Financial Information Statement

The non-financial information provided in the Strategic Report summarises the material issues the Group has identified in line with the new requirements, alongside information around risks, action taken, due diligence and performance for these topics. Specifically, the Group's response to its material, social impacts, employee issues, respect for human rights, anti-corruption and anti-bribery is outlined.

Reporting requirement	Policies and standards which govern our approach	Risk management and additional information
Environmental matters	• CSR Strategy	CSR page 8
Employees [1]	• Code of Business Conduct and Ethics [2] • Employee Handbook [2] • Health and Safety Policy [2] • Diversity and Equal Opportunity Policy [2]	Employees page 9
Human rights	• Modern Slavery Statement • Data Protection Policy [2]	Business Conduct and Ethics pages 10 – 11
Social matters	• Voluntary Work Policy [2] • CSR Strategy	CSR page 8
Anti-corruption and anti-bribery	• Financial Crime Manual [2] • Anti-Bribery and Corruption Policy [2] • Anti-Money Laundering Policy [2] • Gifts and Entertainments Policy [2]	Business Conduct and Ethics pages 10 – 11 Principle Risks pages 14 – 15
Policy embedding, due diligence and outcomes		Principle Risks and Uncertainties pages 14 – 15
Description of principal risks and impact of business activity		Principle Risks pages 14 – 15 Generating Value page 7
Description of the business model		Business Model pages 4 – 5
Non-financial key performance indicators		Non-Financial KPIs page 12

[1] Employees are employed by HCC Service Company, Inc. (UK branch) and HCC Global Financial Products S.L but undertake activities on behalf of the Group, therefore all disclosures provided in respect of employees should be read accordingly.

[2] Internal policies are not published externally and form part of the governance framework.

Strategic Report continued

Principal Risks and Uncertainties

The Group has identified the principal risks arising from its activities and the Board has established appetites covering the amount and type of risk the Group is prepared to seek, accept or tolerate. These appetites are embedded in the policies, procedures and mitigation frameworks that are in place to manage the risks. The Group maintains a risk register and categorises its risks into six areas: Insurance; Strategic, Regulatory and Group; Market; Operational; Credit; and Liquidity. These risk areas, along with the actions taken by the Group to manage and mitigate, are discussed below with further detail provided in Note 5.

Given the nature of the Group's business the largest risks fall under the category of Insurance risk, specifically Reserving risk, reflecting the significant long tail reserves held by the Group and unexpected losses, either catastrophe or systemic, that fall outside business plan parameters. These risks are closely monitored and robustly managed.

In addition to monitoring the Group's existing and established principal risks, the risk management framework is designed to support the identification of developing and emerging risks; those which have the potential to impact, or require a review of, the existing strategic objectives. During 2018 there has been notable development in the following risks:

- Uncertainties related to Brexit;
- Cyber risk, from both an underwriting and operational perspective; and
- Sustainability risk, including Climate Change.

Brexit

As discussed in the Business Structure section on pages 2 and 3, the Group incorporated TME, a subsidiary based in Luxembourg in response to the Brexit risk. Through this establishment the Group has ensured that TME, its European subsidiary, can continue to seamlessly service its European clients' business irrespective of the type of Brexit ultimately achieved.

Cyber risk

The Group's cyber risk includes operational and underwriting (affirmative and non-affirmative) cyber risk. The nature of this risk differs from the other Insurance risks, as it is still in its early stages of maturity, which means that the market's assessment of the potential impacts is continuing to develop and consequently there is a greater level of uncertainty surrounding this risk.

Because of this uncertainty, the Group continually reviews its approach to the management of operational cyber risk (which includes cyber-attacks leading to the loss of sensitive data or failure of IT systems) to ensure optimum management of this evolving risk. Steps taken to date involve the identification of factors which would result in an elevated operational cyber risk profile, including insufficient security of the Group's networks, of applications and data, inadequate business continuity strategies and lack of end user education. Each of these drivers has a robust control framework in place to mitigate the potential impacts and these are reviewed on a regular basis to ensure they continue to reflect current best practice.

The Group manages its underwriting cyber risk (affirmative and non-affirmative) in the same way it does each of its core risks. A defined risk appetite informs the key metrics used to monitor adherence with the risk appetites. These metrics are then reported via the governance structure.

Sustainability risk

The Group understands the importance of managing business in a manner which addresses the risks and opportunities arising from potential long-term systemic risks. The risks associated with sustainability, i.e. environmental, social and governance factors are recognised and have been informally considered within the Group's strategy, underwriting and training processes. Further consideration of how these risks should be addressed is being formalised via the strategy, governance, and risk management frameworks.

Adaptive to Change Adept in Challenging

Risk	Description	How the Group manages/mitigates its risks
Insurance	The Group's insurance business assumes the risk of loss from persons or organisations that are themselves directly exposed to an underlying loss. Insurance risk arises from this risk transfer due to inherent uncertainties about the occurrence, amount and timing of insurance liabilities. The four key components of insurance risk are premium or future underwriting risk (including delegated authorities), reinsurance purchasing, claims management and reserving.	• An underwriting strategy that seeks a diverse and balanced portfolio of risks. • A reserving policy to produce accurate and reliable estimates that are consistent over time and across classes of business. • Setting and regularly monitoring risk appetites. • Individual authority limits for all employees authorised to underwrite and business plans for each line of business. • Claims teams focused on delivering quality, reliability and timely service to both internal and external clients. • Using reinsurance to protect the Group's balance sheet. • Monitoring exposures using modelling tools.
Strategic, Regulatory and Group	Risks which arise from: • the Groups' strategy being inappropriate or the Group being unable to implement its strategy: • the Group not complying with regulatory and legal requirements: and • the Group failing to consider the impact of their activities on other parts of the TMHCC Group.	• Setting and regularly monitoring risk appetites. • A management structure that encourages organisational flexibility and adaptability, while ensuring that activities are appropriately coordinated and controlled. • Operating across the TMHCC Group with clear and open lines of communication to ensure all TMHCC Group entities are well informed and working towards common goals.
Market	Market risk arises where the value of assets and liabilities or future cash flows change because of fluctuations in economic variables, such as movements in foreign exchange rates, interest rates and market prices.	• The Group's Investment Committee has an objective to ensure funds are invested in accordance with the 'prudent person principle', whereby: i) assets are of appropriate security, quality and liquidity; ii) are adequately diversified and are localised; and iii) broadly match the liabilities. • Adhering to an investment risk appetite which form part of the Group's overall risk appetites. • Setting and regularly monitoring risk appetites. • Independent investment experts assist with the implementation of the investment strategy and monitoring of the economic environment and investment performance.
Operational	Operational risk arises from the risk of losses due to inadequate or failed internal processes, people, systems, service providers or external events. Operational risk includes conduct risk.	• Performing business activities in a fair, honest and transparent manner that complies fully with applicable UK and International legal and regulatory requirements, and internal policies and procedures. • Setting and regularly monitoring risk appetites. • Scenario testing and modelling operational risk exposure. • Management review of operational activities, including IT and IT security. • Documented policies and procedures. • Ensuring key processes include preventative and detective controls. • Business Continuity and contingency planning. • Established and embedded systems controls.
Credit	Credit risk arises where counterparties fail to meet their financial obligations in full as they fall due. The primary sources of credit risk for the Group are from reinsurers; brokers and coverholders; investments; and financial institutions holding cash.	• Setting and regularly monitoring risk appetites. • Limiting exposure to a single counterparty or a group of counterparties. • Established guidelines and approval procedures for counterparties.
Liquidity	Liquidity risk arises where cash may not be available to pay obligations when due at a reasonable cost. The Group is exposed to daily calls on its available cash resources, principally from claims arising from its insurance business. In most cases, these claims are settled from premiums received.	• Liquidity management: – using cash flow forecasting to ensure that surplus funds are invested to achieve a higher rate of return; and – so that the Group can reasonably survive a significant individual or market loss event.

Strategic Report continued

Financial KPIs

Gross premiums written

2018 **$657.5m**

2017 $563.1m

Increase of $94.4m

Underwriting result

Balance on technical account (before investment income)

2018 **$87.1m**

2017 $66.1m

Increase of $21m

Net premiums written

Net of reinsurance

2018 **$515.6m**

2017 $460.3m

Increase of $55.3m

Net loss ratio

Ratio of net incurred claims to net earned premiums

2018 **43.3%**

2017 44.7%

Decrease of 1.4%

Net combined ratio

Ratio of total technical charges (before investment income and equalisation provision) to net earned premiums

2018 **82.2%**

2017 85.5%

Decrease of 3.3%

Investment income

Earned investment income transferred from the Non-Technical Account

2018 **$25.7m**

2017 $32.3m

Cash and investments

Excluding investment in subsidiaries and land and buildings

2018 **$1,264.4m**

2017 $1,283.3m

Consolidated shareholder's funds

2018 **$755m**

2017 $681.4m

Increase of $73.6m

Proven Ability Long-term Stability

Business Performance and Position

Results and Performance

The Group made a net profit before tax for the financial year of $90.5m (2017: $71.2m) and includes a balance on the technical account for general business of $112.8m (2017: $98.4m), which includes investment income of $25.7m (2016: $32.3m).

The balance on the technical account excluding investment income is $87.1m (2017 $66.1m), showing a combined ratio of 82.2% (2017: 85.5%), with strong profits from both the London Market and Specialty segments. The Specialty segment continued to benefit from organic growth, an improving rating environment for some parts of its Financial Lines portfolio and strong earnings with good loss experience from the Professional Risks and Credit & Political Risk sub-segments. This was dampened somewhat by lower profitability in the Surety sub-segment with several large current year market losses impacting the portfolio after several years of relatively benign loss experience. 2018 also benefitted from the 2017 exit from the EMEA Travel business which had poor performance in 2017. The London Market segment benefitted from market conditions following 2017 market catastrophe losses. In addition to better than expected rate increases across all the London Market lines of business, the Group was well positioned to offer capacity as competitors were forced to tighten previously offered capacity in response to the effect of losses from the 2017 global market catastrophe losses.

2018 US catastrophes had no significant effect on the 2018 loss ratios consistent with 2017. Total prior accident year reserve releases totalled $23.3m (2017: $22.5m) reducing the loss ratio by 4.7% (2017: 4.6%).

Investment income transferred to the technical account is comprised principally of earned investment income reflecting the Group's approach to managing earned income. Its solid operating cash flow and robust capital position supports this approach over one of managing total yield inclusive of unrealised gains and losses.

The non-technical account includes items which in total reduced the balance on the technical account for general business by $22.3m (2017: $27.3m reduction). This was driven by net unrealised losses on the Group's fixed income portfolio of $18.9m (2017: $0.5m) which is consistent with the effect of US interest rate rises during the year on the Group's investment portfolio which is principally in US dollar fixed income securities. Following the sale of the equity portfolio in 2018, the Group invested in a new alternative asset class which totalled approximately 3% of the portfolio at 31 December 2018. This adds diversification to the investment portfolio and is well within the maximum allocation specified in the investment risk appetite.

Overall, the directors are satisfied with the Group's operations and its financial position at 31 December 2018.

Gross Premiums Written

2018 gross premiums written increased by $94.4m to $657.5m (2017: $563.1m). After eliminating the effect of weaker sterling and Euro against the US dollar in 2017 (on average in 2018 sterling and Euro strengthened against the US dollar by 3.1% and 4.5%, respectively), underlying premium increased by $80.2m. The $80.2m increase was driven by the growth in the Specialty business largely due to Financial Lines and an increase in London Market business which was offset to some extent by the Group's exit from the Lifestyle Travel Medical business which is included in Other.

The foreign exchange effect on gross premiums written is shown in the table below:

Gross Premiums Written	2018 GPW	2017 GPW	Increase/(Decrease)		2017 GPW at 2018 rate	Increase/(Decrease) (excl. FX effect)	
	$m	$m	$m	% change	$m	$m	% change
Financial Lines	187.4	124.5	62.9	50.5%	127.6	59.8	46.9%
Professional Risks	136.3	124.4	11.9	9.6%	128.1	8.2	6.4%
Credit & Political Risk	98.2	99.5	(1.3)	(1.3)%	101.5	(3.3)	(3.3%)
Surety	90.3	80.4	9.9	12.3%	83.2	7.1	8.5%
Other	5.9	28.2	(22.3)	(79.1)%	29.1	(23.2)	(79.8%)
Total Specialty Segment	**518.1**	**457.0**	**61.1**	**13.4%**	**469.5**	**48.6**	**10.4%**
Marine & Energy	52.5	40.6	11.9	29.3%	40.9	11.6	28.4%
Property Treaty	66.2	52.3	13.9	26.6%	53.6	12.6	23.5%
Property D&F and A&H	20.7	13.2	7.5	56.8%	13.3	7.4	55.6%
Total London Market	**139.4**	**106.1**	**33.3**	**31.4%**	**107.8**	**31.6**	**29.3%**
Total	**657.5**	**563.1**	**94.4**	**16.8%**	**577.3**	**80.2**	**13.9%**

Strategic Report continued

Specialty

Financial Lines

Gross premiums written increased to $187.4m (2017: $124.6m). The Financial Lines business includes principally Directors and Officers ('D&O') liability, Cyber and Transaction Risk Insurance ('TRI') business. The business written out of London continued to benefit from some market hardening and new business opportunities in Commercial D&O and Professional Indemnity which will boost net earned premium in 2019. TRI business contributed to half of the growth. The business written out of the other offices in Barcelona and Munich also experienced some robust organic growth although the market remains competitive in the main Continental European markets.

Professional Risks

Gross premiums written increased 9.6% to $136.3m (2017: $124.4m). The business includes two main product lines, Professional Indemnity and Liability. As in previous years the solid organic growth results from product development, new business initiatives in lower hazard trades, the development of our online offering and our strong regional office network. The Professional Risks business is high volume, low premium business underwritten through a broad network of brokers with a major emphasis on IT automation and client servicing. The strategic acquisition of QHL will lower the acquisition cost on this business from 1 January 2019.

Credit & Political Risk

Gross premiums written is in line with 2017 at $98.2m (2017: $99.5m). Through its two specialised underwriting teams, the Group offers a full range of Credit and Political Risk insurance solutions for both financial institutions and small and large commercial companies. The largest team focuses on our UK whole turnover Credit business where our high service standards in both underwriting and claims handling positions the Group as one of the major insurers in the UK and allows us to experience high retention levels. The UK market sector is currently particularly challenging given economic uncertainties and ongoing difficulties within the UK retail sector. Despite the challenging environment the Credit and Political Risk team maintained its market position and continued to lead major international risk placements benefiting from the Group's financial rating.

Surety

Gross premiums written has increased 12.2% to $90.3m (2017: $80.4m). The Group's position in the market and its strong S&P rating provides good opportunities to sell performance bonds and other bond products that support large multi-national companies involved in significant infrastructure projects. The strategy to target larger bonds continues to succeed and the Group is now expanding by way of participation agreements with several banking clients.

Other

Comprises principally the Lifestyle Travel Medical business written in the UK which was discontinued from January 2017.

London Market

Marine & Energy

Gross premiums written increased 29.3% to $52.5m (2017: $40.6m). The increase was driven by better rating conditions combined with continued measured growth of the Marine business. The Energy market rating environment improved in 2018 resulting from a sustained increase in oil prices and decreased capacity in the catastrophe exposed business. The Marine market benefited from a materially improved rating environment and the portfolio is growing through the focus on leadership, group synergies and a continued shift of the book of business, resulting in a more diversified Marine portfolio. Additionally, we are expanding into Marine Liability business with the addition of a market leading Marine Liability team.

Property Treaty

Gross premiums written increased 26.6% to $66.2m (2017: $52.3m). The portfolio is comprised principally of European and rest of the world excess of loss reinsurance business. The strategy of participation on high programme layers and strong client relationships creates a competitive advantage; and combined with a sustainable reinsurance programme has consistently produced profitable results. The class benefitted from an improved rating environment and the Group's utilisation of aggregates which previously had been restrained due to soft market conditions.

Property Direct & Facultative and Accident & Health

Gross premiums increased 56.8% to $20.7m (2017: $13.2m). Growth in Property Direct and Facultative has come from an increased line size deployed into a fast-improving marketplace following the impact of large Cats through 2017 and 2018. Conditions continue to materially improve, and future growth opportunities are anticipated. Our A&H portfolio continues to maintain market leading profitability due to disciplined underwriting and realistic growth expectations.

Investment performance

The investment function is overseen by the investment committee which operates under terms of reference set by the Group's Board. The investment committee is responsible for preparing, in conjunction with the Group's investment managers, the investment policy for approval by the Board. It is also responsible for monitoring investment performance and recommending the appointment of investment managers.

New England Asset Management was the investment manager for the US Dollar, Sterling, Euro and Swiss Franc funds throughout the year. The funds consist primarily of a portfolio of highly rated Corporate Bonds, which are BBB rated and above, including Bonds guaranteed by the US, UK and German governments. The average duration of the aggregate portfolios at the year-end was 3.97 years (2017: 3.81 years). Delphi Financial Group, Inc. (Delphi) an investment manager within the TM Group, manages the alternative investment class entered into in 2019.

Balance sheet

The balance sheet of the group shows total assets of $2,098.1m (2017: $1,962.1m) and shareholder's equity of $755.0m (2017: $681.4m). Of the total assets, $1,264.4m, i.e. 60.3% (2017 $1,283.3m, 65.4%) is represented by financial investments and cash at bank. Net technical liabilities from insurance contracts were $792.7m (2017: $747.0m).

HCCII's regulatory solvency position is measured on a 'solo' basis which requires the treatment of the strategic investments in TME and QHL on a Solvency II 'look through' basis with additional capital requirements equal to those required for other equity investments. This results in a solvency margin of 180% at 31 December 2018 (2017:>200%).

Inspired Solutions Inspiring Confidence

Future Outlook

The Group's strategy includes continued expansion of its brand with presence in the UK regional market, the London Market and throughout the rest of Europe; and the identification and development of opportunities to grow its business. It is well positioned to further expand its European business through TME which benefits from an AA- S&P Rating.

In line with these strategic objectives, in 2019 the Group has continued to grow its business through the establishment of a new line of business (Marine Liability) and the expansion of its existing surety portfolio into Continental Europe.

Marine Liability

In January 2019 the Group started underwriting a new line of business, Marine Liability, in the London Market segment. As with the Group's other accounts, the Marine Liability portfolio will be well-balanced and comprised of a range of non-correlating sub-classes including: Marine Trades, Marine Property (Incidental), US Primary, Energy Liabilities, Open Market Marine Liabilities and Mutual Reinsurance. The business written by the Marine Liability account will bring some aggregation with other Marine classes already written by the Group, but is largely a diversifier within the wider insurance and reinsurance business, and the approach of the Marine Liability underwriters will ensure diversity within the portfolio in order to achieve a strong and consistent underwriting profit.

European Surety

UK risks have traditionally comprised the majority of the Group's Surety business, however in recent years the account has seen an increasing amount of European business, particularly from France, Ireland, Scandinavia and Netherlands. Consequently, in 2019 Surety commenced its expansion into Continental Europe and the Group now has Surety underwriters based at offices in Germany, France, Luxembourg, Denmark. This will enable the Group to continue to build a Continental European Surety team and develop a significant portfolio of European Risks.

On behalf of the board

BJ Cook
Chief Executive Officer

1 Aldgate
London EC3N 1RE

4 April 2019

Directors' Report

The directors present their Directors' Report and the audited financial statements of the Company for the year ended 31 December 2018.

Directors' Report content

The directors present their Directors' Report and the audited financial statements of the Group for the year ended 31 December 2018.

The Strategic Report is set out on pages 2-19 and the Directors' Report is set out on pages 20 and 21. The Strategic Report is incorporated by reference into this Directors' Report and should be read as part of it.

Strategic Report

The Group is required to produce a fair review of the Group's business for the financial year. The Strategic Report details the Group's business strategy and business model, location of branches outside the UK, a description of the principal risks and uncertainties, a review of the Group's activities and the position of the Group at 31 December 2018 as well as its prospects for the future.

Board of directors

The directors of HCCII set out below have held office from 1 January 2018 to the date of this report unless otherwise stated:

S A Button
B J Cook (Chief Executive Officer)
T J G Hervy
N I Hutton-Penman
H Ishii (non-executive – Resigned 31 March 2019)
K L Letsinger
N C Marsh (non-executive Chairman)
H-D Rohlf (non-executive)
C Scarr (non-executive)
G R A White

Indemnification of directors and directors' and officers' insurance

The directors have the benefit of an indemnity provision contained in HCCII's articles of association and to the extent permitted by law, HCCII may indemnify its directors out of its own funds to cover liabilities arising as a result of their office.

Throughout the financial year, the Group has maintained director's and officers' liability insurance as defined by section 236 of the Companies Act 2006.

Conflicts of interest

The Board has a comprehensive procedure for reviewing, and as permitted by the Companies Act 2006 and the Group's articles of association, approving actual and potential conflicts of interest. Directors have a duty to notify the Chairman and Company Secretary as soon as they become aware of actual or potential conflict situations.

Financial instruments

Information on the use of financial instruments by the Group and its management of financial risk is disclosed in Note 5 to the financial statements. The Group's exposures to price risk, credit risk and liquidity risk are separately disclosed in that note. The Group's exposure to cash flow risk is addressed under the headings of 'Credit risk', 'Liquidity risk' and 'Market risk'.

Independent auditor and disclosure of audit information

Each of the directors who held office at the date of approval of this Directors' Report confirms that, so far as each director is aware, there is no relevant audit information of which the Group's auditor is unaware and each director has taken all the steps that ought to have been taken in their duty as a director to make himself/herself aware of any relevant audit information and to establish that the Group's auditor is aware of that information.

The audit committee recommended, and the Board approved, the proposal that the current auditors PricewaterhouseCoopers LLP, be re-appointed as auditors of the Group in respect of both the annual UK GAAP financial statements and the Solvency II regulatory returns.

Statement of directors' responsibilities

The directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulation.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have prepared the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards, comprising FRS 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland", and applicable law). Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the of the Group and of the profit or loss of the Group for that period. In preparing the financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- state whether applicable United Kingdom Accounting Standards, comprising FRS 102, have been followed, subject to any material departures disclosed and explained in the financial statements;
- make judgements and accounting estimates that are reasonable and prudent; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Group's transactions and disclose with reasonable accuracy at any time the financial position of the Group and enable them to ensure that the financial statements comply with the Companies Act 2006.

The directors are also responsible for safeguarding the assets of HCCII and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors are responsible for the maintenance and integrity of the Group's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Going concern

The Group's business activities, together with the factors likely to affect its future development performance and position are set out in the Strategic Report.

The directors have a reasonable expectation that HCCII and the Group have adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the financial statements.

Share capital

HCCII's issued share capital as at the date of this Directors' Report is comprised of a single class of 96,047,813 Ordinary Shares of £1.00 each and 70,197,000 Ordinary shares of $1.00 each.

Voting

Each Ordinary Share of HCCII carries one vote.

Substantial shareholding

At the date of this Directors Report the shareholder with 100% shareholding in HCCII was Tokio Marine HCC Insurance Holdings (International) Limited.

Dividends

Dividend paid during the year totalled $nil (2017: $nil). No final dividend is recommended.

Post balance sheet events

As part of HCCII's strategic plan for maintaining and growing its business following Brexit, effective 1 January 2019 HCCII transferred its European branch technical net assets to new branches of its subsidiary TME. The process has followed the Part VII transfer protocol in accordance with both UK and Luxembourg company law and has been approved by the Luxembourg regulator (Commissariat aux Assurances). HCCII's affiliate company TMKI also made a Part VII transfer to TME in January 2019.

On behalf of the Board

J L Holliday
Company Secretary
Registered in England and Wales at
1 Aldgate
London, EC3N 1RE
Company number 01575839

4 April 2019

Complex Challenges Complete Solutions

Independent Auditors' Report to the Members of HCC International Insurance Company plc

Report on the audit of the financial statements

Opinion

In our opinion, HCC International Insurance Company plc's Group financial statements and Company financial statements (the "financial statements"):

- give a true and fair view of the state of the Group's and of the Company's affairs as at 31 December 2018 and of the Group's profit and cash flows for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards, comprising FRS 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland", and applicable law); and
- have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements, included within the Annual report and consolidated financial statements (the "Annual Report"), which comprise: the consolidated and Company balance sheets as at 31 December 2018; the consolidated profit and loss account and consolidated statement of other comprehensive income, the consolidated statement of cash flows, and the consolidated and Company statements of changes in shareholder's equity for the year then ended; and the notes to the financial statements, which include a description of the significant accounting policies.

Our opinion is consistent with our reporting to the Audit Committee.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities under ISAs (UK) are further described in the Auditors' responsibilities for the audit of the financial statements 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 Group in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, which includes the FRC's Ethical Standard, as applicable to public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

To the best of our knowledge and belief, we declare that non-audit services prohibited by the FRC's Ethical Standard were not provided to the Group or the Company.

Other than those disclosed in note 9 to the financial statements, we have provided no non-audit services to the Group or the Company in the period from 1 January 2018 to 31 December 2018.

Our audit approach

Overview

- Overall Group materiality is $5.7 million. This represents the amount it would take to increase the Combined Operating Ratio ("COR") by 1%.
- Overall Company materiality is $5.6 million. This represents the amount it would take to increase the COR by 1%.
- The Group's financial reporting includes transactions and balances derived from financial information of the Company's UK operations, its European branches and subsidiaries.
- We performed full scope audit procedures over the Company's UK operations which had the most significant impact on the financial statements. We also identified the Company's Spanish branch as a significant component, where specific account balances associated with the key audit matter on the following page were tested.
- We identified certain other operations where account balances were significant by virtue of materiality in size or audit risk. We scoped our audit to include detailed testing of these account balances.
- Our risk assessment identified the valuation of claims incurred but not reported ('IBNR') reserves and the associated reinsurers' share of claims IBNR reserves (Group and Company) as an area of focus.

Our audit approach

The scope of our audit

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the financial statements.

Capability of the audit in detecting irregularities, including fraud

Based on our understanding of the Group and industry, we identified that the principal risks of non-compliance with laws and regulations related to breaches of UK and European regulatory principles, such as those governed by the Prudential Regulation Authority and the Financial Conduct Authority, and we considered the extent to which non-compliance might have a material effect on the financial statements. We also considered those laws and regulations that have a direct impact on the preparation of the financial statements such as the Companies Act 2006, Prudential Regulation Authority's regulations, UK tax legislation, and equivalent local laws and regulations to in scope components. We evaluated management's incentives and opportunities for fraudulent manipulation of the financial statements (including the risk of override of controls), and determined that the principal risks were related to management bias in accounting estimates and judgmental areas of the financial statements as shown in the Key Audit Matters section on page 24. The Group engagement team shared this risk assessment with the component auditors so that they could include appropriate audit procedures in response to such risks in their work. Audit procedures performed by the Group engagement team and/or component auditors included:

- Discussions with the Board, management, internal audit, senior management involved in the Risk and Compliance functions and the Group and Company's legal function, including consideration of known or suspected instances of non-compliance with laws and regulation and fraud;
- Assessment of matters reported on the Group and Company's whistleblowing helpline and fraud register and the results of management's investigation of such matters;
- Reading key correspondence with the Prudential Regulation Authority, the Financial Conduct Authority and other regulators (where applicable) in relation to compliance with relevant laws and regulations;
- Reviewing relevant meeting minutes including those of the Risk and Capital Management Committee and the Audit Committee;
- Identifying and testing journal entries, in particular any journal entries posted with unusual account combinations or posted by senior management;
- Designing audit procedures to incorporate unpredictability around the nature, timing or extent of our testing; and
- Testing transactions entered into outside of the normal course of the Group and Company's business.

There are inherent limitations in the audit procedures described above and the further removed non-compliance with laws and regulations is from the events and transactions reflected in the financial statements, the less likely we would become aware of it. Also, the risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting one resulting from error, as fraud may involve deliberate concealment by, for example, forgery or intentional misrepresentations, or through collusion.

Independent Auditors' Report to the Members of HCC International Insurance Company plc continued

Key audit matters
Key audit matters are those matters that, in the auditors' professional judgement, were of most significance in the audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by the auditors, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. These matters, and any comments we make on the results of our procedures thereon, were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. This is not a complete list of all risks identified by our audit.

Key audit matter	How our audit addressed the key audit matter
Valuation of claims incurred but not reported ('IBNR') reserves and the associated reinsurers' share of claims IBNR reserves Claims IBNR reserves and the associated reinsurers' share of claims IBNR reserves are a subset of "claims outstanding" within technical provisions, and they represent significant accounting estimates in the financial statements. As at 31 December 2018, the value of claims IBNR reserves and the associated reinsurers' share of reserves is $376 million and $105 million respectively. These estimates are included within gross claims outstanding of $768 million and the reinsurers' share of claims outstanding of $241 million respectively as set out in Note 22. The Group's claims IBNR reserves and the associated reinsurers' share of reserves represent those of the Company only. The methodologies and assumptions used by the directors to estimate claims IBNR reserves and the associated reinsurers' share of claims IBNR reserves involves a significant degree of judgement. Key areas of focus this year were: • The underlying volatility attached to estimates for the larger classes of business, such as Financial Lines and Liability classes, where small changes in assumptions can lead to large changes in the level of the estimate held. • The risk of inappropriate assumptions used in determining current year estimates of claims IBNR reserves and the associated reinsurers' share of claims IBNR reserves. Given that limited data is available for some classes of business, there is greater reliance on expert judgement in their estimation. • The consistency of the directors' approach to estimating claims IBNR reserves and the associated reinsurers' share of claims IBNR reserves and adjustments recognised to reflect uncertainty for specific claims.	We have understood, evaluated and tested the design and operational effectiveness of relevant controls in place in respect of the valuation of claims IBNR reserves and the associated reinsurer's share of claims IBNR reserves, which included controls over the reconciliation of data from the underlying systems and the review and approval of the claims IBNR reserves and the associated reinsurers' share of claims IBNR reserves by the directors. On a sample basis we have also agreed underlying source data back to supporting documentation. In performing our detailed audit work over the valuation of claims IBNR reserves and the associated reinsurer's share of claims IBNR reserves we used actuarial specialists. Our procedures included: • Developing independent point estimates for classes of business considered to be higher risk, particularly focusing on the largest and most uncertain estimates, as at 31 August 2018 and performing roll-forward procedures to 31 December 2018. For these classes, we compared our re-projected estimates to those booked by the directors to form part of our determination as to whether the overall estimate of claims IBNR reserves represented a reasonable estimate; • Testing, for certain other classes of business, the methodology and assumptions used by the directors to derive the claims IBNR reserve estimates and assessing whether these produced reasonable estimates based on underlying facts and circumstances; • Performing analytical audit procedures over the remaining classes of business to ascertain the reasonableness of the claims IBNR reserves; and • Applying gross to net ratios against the estimated claims IBNR reserves to calculate the estimated reinsurers' share of claims IBNR reserves. Based on the work performed we found that the claims IBNR reserves and the associated reinsurers' share of claims IBNR reserves were supported by the evidence we obtained.

How we tailored the audit scope
We tailored the scope of our audit to ensure that we performed enough work to be able to give an opinion on the financial statements as a whole, taking into account the structure of the Group and the Company, the accounting processes and controls, and the industry in which they operate.

Using the outputs from our risk assessment, along with our understanding of the Group, we scoped our audit based on the significance of the results and financial position of individual components relevant to the Group result and financial position. In doing so, we also considered qualitative factors and ensured we had obtained sufficient coverage across all financial statement line items in the financial statements. Our scoping provided us with coverage of over 85% of consolidated profit before tax, and over 90% of consolidated total assets respectively.

Based on the outputs of our audit scoping exercise, we identified the Group's components to be the Company, its European branches and subsidiaries. We performed a full scope audit of the Company's UK operations as it had the most significant impact on the financial statements. We also identified the Company's Spanish branch as a significant component, where specific account balances addressing the key audit matter were tested.

For the remaining components, we identified certain account balances which were considered to be significant in size or audit risk, and scoped the audit to include detailed testing of these account balances.

As the Group engagement team, we determined the level of involvement required by other auditors to be able to conclude whether sufficient and appropriate audit evidence had been obtained as a basis for our opinion on the financial statements as a whole.

We exercised oversight over the work performed by other auditors by maintaining regular and timely communication, including performing video-calls, discussions and written communications as appropriate.

Materiality
The scope of our audit was influenced by our application of materiality. We set certain quantitative thresholds for materiality. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures on the individual financial statement line items and disclosures and in evaluating the effect of misstatements, both individually and in aggregate on the financial statements as a whole.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

	Group financial statements	Company financial statements
Overall materiality	$5.7 million.	$5.6 million.
How we determined it	These amounts represent the amount it would take to increase the Combined Operating Ratio ("COR") by 1%.	
Rationale for benchmark applied	In determining materiality, we considered financial metrics which we believe relevant to the primary users of the Group and Company's financial statements. We concluded that the COR was the most relevant benchmark as it provides an indicator of relative performance and is a focus of the directors.	

Independent Auditors' Report to the Members of HCC International Insurance Company plc continued

For each component in the scope of our Group audit, we allocated a materiality that is less than our overall Group materiality. The range of materiality allocated across components was between $3.0 million and $5.6 million. Certain components were audited to a local statutory audit materiality that was also less than our overall Group materiality.

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above $0.3 million (Group audit) and $0.3 million (Company audit) as well as misstatements below those amounts that, in our view, warranted reporting for qualitative reasons.

Conclusions relating to going concern

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

- the directors' use of the going concern basis of accounting in the preparation of the financial statements is not appropriate; or
- the directors have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the Group's and Company'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 financial statements 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 Group's and Company's ability to continue as a going concern. For example, the terms on which the United Kingdom may withdraw from the European Union are not clear, and it is difficult to evaluate all of the potential implications on the Group's and Company's trade, customers, suppliers and the wider economy.

Reporting on other information

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

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements 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 financial statements 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 Strategic Report and Directors' Report, we also considered whether the disclosures required by the UK Companies Act 2006 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.

Strategic Report and Directors' Report

In our opinion, based on the work undertaken in the course of the audit, the information given in the Strategic Report and Directors' Report for the year ended 31 December 2018 is consistent with the financial statements and has been prepared in accordance with applicable legal requirements.

In light of the knowledge and understanding of the Group and Company and their environment obtained in the course of the audit, we did not identify any material misstatements in the Strategic Report and Directors' Report.

Responsibilities for the financial statements and the audit

Responsibilities of the directors for the financial statements

As explained more fully in the Statement of directors' responsibilities set out on page 20, the directors are responsible for the preparation of the financial statements in accordance with the applicable framework and for being satisfied that they give a true and fair view. The directors are also responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the Group's and the Company'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 the directors either intend to liquidate the Group or the Company or to cease operations, or have no realistic alternative but to do so.

Auditors' responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements 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 financial statements.

A further description of our responsibilities for the audit of the financial statements 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 Company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 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

Companies Act 2006 exception reporting

Under the Companies Act 2006 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 Company, or returns adequate for our audit have not been received from branches not visited by us; or
- certain disclosures of directors' remuneration specified by law are not made; or
- the Company financial statements are not in agreement with the accounting records and returns.

We have no exceptions to report arising from this responsibility.

Appointment

Following the recommendation of the audit committee, we were appointed by the directors on 14 July 2005 to audit the financial statements for the year ended 31 December 2005 and subsequent financial periods. The period of total uninterrupted engagement is 14 years, covering the years ended 31 December 2005 to 31 December 2018. There was a competitive tender process conducted by the Audit Committee during 2017. At the recommendation of the Audit Committee, we were re-appointed by the directors on 4 July 2017 as auditors for the year ended 31 December 2017.

Paul Pannell (Senior Statutory Auditor)
for and on behalf of
PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors

London
4 April 2019

Consolidated Profit and Loss Account

For the year ended 31 December 2018

Technical account – general business	Note	2018 $'000	2017 $'000
Earned premiums, net of reinsurance			
Gross premiums written	6	657,469	563,108
Outward reinsurance premiums		(141,915)	(102,782)
Net premiums written		**515,554**	**460,326**
Change in the gross provision for unearned premiums		(42,311)	(863)
Change in the provision for unearned premiums, reinsurers' share		17,526	(4,147)
Change in the net provision for unearned premiums		**(24,785)**	**(5,010)**
Earned premiums, net of reinsurance		**490,769**	**455,316**
Earned investment income transferred from the non-technical account	7	25,655	32,305
Other technical income	11	5,260	3,451
Total technical income		**521,684**	**491,072**
Claims incurred, net of reinsurance			
Claims paid:			
– gross amount		(246,587)	(248,908)
– reinsurers' share		85,345	68,741
Net claims paid		**(161,242)**	**(180,167)**
Change in the provision for claims:			
– gross amount		(9,382)	(9,293)
– reinsurers' share		(41,716)	(14,177)
Change in the net provision for claims		**(51,098)**	**(23,470)**
Claims incurred, net of reinsurance		**(212,340)**	**(203,637)**
Net operating expenses	8	(196,549)	(188,986)
Total technical charges		**(408,889)**	**(392,623)**
Balance on the technical account for general business	**6**	**112,795**	**98,449**

All results derive from continuing operations

Non-Technical account	Note	2018 $'000	2017 $'000
Balance on the technical account for general business		112,795	98,449
Income from other financial investments	7	27,436	26,490
Realised gains on financial investments	7	–	7,289
Realised losses on financial investments	7	(370)	–
Investment management fees and charges	7	(1,411)	(1,474)
		25,655	32,305
Earned investment income allocated to the general business technical account		**(25,655)**	**(32,305)**
Unrealised losses on financial investments	7	(18,888)	(457)
Bank interest receivable and similar income	7	364	152
		(18,524)	(305)
Net foreign exchange gains / (losses) on revaluation of monetary items		9,344	(20,049)
Other charges and other operating expenses	10	(13,158)	(6,897)
Profit on ordinary activities before tax		90,457	71,198
Tax on profit on ordinary activities	12	(16,237)	(16,494)
Profit for the financial year		**74,220**	**54,704**

Consolidated Statement of Other Comprehensive Income

For the year ended 31 December 2018

	Note	2018 $'000	2017 $'000
Profit for the financial year		74,220	54,704
Currency translation differences		(616)	820
Total consolidated comprehensive income		**73,604**	**55,524**

The Consolidated Profit and Loss account and Consolidated Statement of Other Comprehensive Income should be read in conjunction with the accompanying notes.

Consolidated Balance Sheet

As at 31 December 2018

	Note	2018 $'000	2017 $'000
ASSETS			
Intangible assets			
Goodwill	13	87,102	549
Other intangible assets	13	38,744	4,635
		125,846	5,184
Investments			
Land and buildings	14	239	239
Other financial investments	17	1,178,614	1,229,757
		1,178,853	1,229,996
Reinsurers' share of technical provisions			
Provision for unearned premiums	22	69,049	54,611
Claims outstanding	22	240,945	289,504
		309,994	344,115
Debtors			
Debtors arising out of direct insurance operations			
– Policyholders		34,049	32,912
– Intermediaries		96,591	75,069
Debtors arising out of reinsurance operations		82,453	52,892
Other debtors	18	34,671	25,609
		247,764	186,482
Other assets			
Tangible assets	19	2,992	2,935
Deposits from third parties		57,646	56,278
Cash at bank and in hand		85,786	53,493
		146,424	112,706
Prepayments and accrued income			
Accrued interest and rent		8,440	8,586
Deferred acquisition costs	22	80,798	75,071
		89,238	83,657
Total assets		2,098,119	1,962,140

	Note	2018 $'000	2017 $'000
LIABILITIES			
Capital and reserves			
Called up share capital	20	233,242	233,242
Other reserve		(1,929)	(1,313)
Profit and loss account		523,675	449,455
Total shareholders' equity		754,988	681,384
Technical provisions			
Provision for unearned premiums	22	334,313	306,236
Claims outstanding	22	768,391	784,851
		1,102,704	1,091,087
Creditors – amounts due within one year			
Creditors arising out of direct insurance operations		13,320	11,313
Creditors arising out of reinsurance operations		76,833	53,671
Other creditors including taxation and social security	21	41,296	33,296
Deposits from third parties		57,721	56,356
		189,170	154,636
Creditors – amounts due after more than one year			
Deferred consideration	16	9,799	–
Accruals and deferred income		41,458	35,033
Total liabilities		2,098,119	1,962,140

In accordance with the exemption permitted under section 408 of the Companies Act 2006, the Company profit or loss account, and Company statement of other comprehensive income are not presented as part of these financial statements. The Company's profit after taxation for the year was $72.5 million (2017: $61.3 million profit).

The financial statements on pages 28 to 71 were approved by the Board of Directors and were signed on its behalf by

K L Letsinger

K Letsinger
Director
4 April 2019

Company registration number 1575839

The Consolidated Balance Sheet should be read in conjunction with the accompanying notes.

Consolidated Statement of Changes in Shareholder's Equity

For the year ended 31 December 2018

Capital and reserves	Called up share capital $'000	Profit and loss account $'000	Currency Exchange reserve $'000	Total shareholders' equity $'000
At 1 January 2018	233,242	449,455	(1,313)	681,384
Profit for the financial year	–	74,220	–	74,220
Other Comprehensive Income	–	–	(616)	(616)
At 31 December 2018	233,242	523,675	(1,929)	754,988

Capital and reserves	Called up share capital $'000	Profit and loss account $'000	Currency Exchange reserve $'000	Total shareholders' equity $'000
At 1 January 2017	233,242	394,751	(2,133)	625,860
Profit for the financial year	–	54,704	–	54,704
Other Comprehensive Income	–	–	820	820
At 31 December 2017	233,242	449,455	(1,313)	681,384

The Consolidated Statement of Changes in Shareholder's Equity should be read in conjunction with the accompanying notes.

Consolidated Statement of Cash Flows

For the year ended 31 December 2018

	Note	2018 $'000	2017 $'000
Net cash Inflow/(Outflow) from operating activities	23	144,856	(18,070)
Interest received		27,800	26,642
Taxation paid		(21,300)	(16,821)
Net cash generated from operating activities		151,356	(8,249)
Cash flow from investing activities			
Acquisition of subsidiary (net of cash and assets acquired)		(118,880)	–
Purchase of tangible assets		(183)	(298)
		(119,063)	(298)
Net increase/(decrease) in cash at bank and in hand		32,293	(8,547)
Cash and cash equivalents at the beginning of the year		53,493	62,040
Cash and cash equivalents at the end of the year		85,786	53,493
Cash and cash equivalents consist of:			
Cash at bank and in hand		85,786	53,493
		85,786	53,493

The Consolidated Statement of cash flows should be read in conjunction with the accompanying notes.

Notes to the Consolidated Financial Statements

1. General information

HCC International Insurance Company PLC ('HCCII') and its subsidiaries (together 'the Group') is authorised by the Prudential Regulation Authority ('PRA') and regulated by both the Financial Conduct Authority and the PRA. The principal activity of HCCII is the transaction of general insurance business in the United Kingdom and Continental Europe where it benefits from the European Union Freedom of Services charter to write across the European Union member states. HCCII operates from a number of offices across the UK and also has branches in Spain, Ireland, France, Switzerland, Germany, Italy and Norway. HCCII is a private company limited by shares and is incorporated in England. The address of its registered office is 1 Aldgate, London EC3N 1RE.

2. Statement of compliance

The Group (HCCII and its subsidiaries) and individual financial statements of HCCII have been prepared in compliance with United Kingdom Accounting Standards, including Financial Reporting Standard 102, ''The Financial Reporting Standard applicable in the United Kingdom and the Republic of Ireland'' (''FRS 102''), Financial Reporting Standard 103, "Insurance Contracts" (FRS 103) and the Companies Act 2006. The Group 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. Summary of significant accounting policies

The principal accounting policies applied in the preparation of these consolidated and separate 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 consolidated financial statements have been prepared in conformity with FRS 102 and 103. The 31 December 2018 year-end is the first year in which the Company has not taken the exception of preparing consolidated financial statements under FRS 102 and the Companies Act.

The Company has therefore produced consolidated financial statements for the year-ended 31 December 2018 including 2017 prior year comparatives. The basis of consolidation is explained more fully below.

FRS 102 and 103 require financial statement disclosure about the use of certain critical accounting estimates for which management has exercised judgement in the process of applying the Group and the Company 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 4.

b. Going concern

Having assessed the principal risks, the directors considered it appropriate to adopt the going concern basis of accounting in preparing the financial statements.

c. Exemptions for qualifying entities under FRS 102

As allowed by FRS 102, the Company has applied certain exemptions as follows:

i. From preparing a statement of cash flows, on the basis that it is a qualifying entity and the consolidated statement of cash flows, included in these financial statements, includes the Company's;

ii. Related party disclosures, and

iii. From disclosing key management personnel compensation, as required by FRS 102 paragraph 33.7.

d. Basis of Consolidation

The Group consolidated financial statements include the financial statements of the Company and all of its subsidiary undertakings made up to 31 December 2018.

A subsidiary is an entity controlled by the Group. Control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. Where the Group owns less than 50% of the voting powers of an entity but controls the entity by virtue of an agreement with other investors which give it control of the financial and operating policies of the entity it accounts for that entity as a subsidiary.

All intra-Group transactions, balances, income and expenses are eliminated on consolidation.

The Company has taken advantage of the exemption in section 408 of the Companies Act from disclosing its individual profit and loss account.

e. Foreign currency

The Group's functional and presentation currency is US Dollars. For subsidiaries whose functional currency is US Dollar, foreign currency transactions are recorded using the spot exchange rates at the dates of the transactions into the functional currency. At each period end, foreign currency monetary assets and liabilities are revalued using the closing rate. For this purpose, all assets and liabilities arising from insurance contracts (including unearned premiums, deferred acquisition costs and unexpired risks provisions) are monetary items. Differences arising on the revaluation of foreign currency amounts to the functional currency are recognised in the non-technical profit and loss account.

For subsidiaries whose functional currency is not US Dollar the results and financial position are translated into the presentation currency as follows:

(a) Assets and liabilities are translated at the closing rate at the balance sheet date;

(b) Income and expenses are translated at the average rate of exchange during the year; and

(c) All resulting exchange differences are recognised in the consolidated statement of other comprehensive income.

f. Insurance contracts

i. Classification of insurance and investment contracts

The Group issues insurance contracts that transfer significant insurance risk.

ii. Insurance contracts

Results are determined on an annual basis whereby the incurred cost of claims, commission and related expenses are charged against the earned proportion of premiums, net of reinsurance, as follows:

Notes to the Consolidated Financial Statements continued

a. Premiums written

Premiums written relates to business incepted during the year, together with adjustments made in the year to premiums written in prior accounting periods. Premiums are presented gross of brokerage payable and exclude taxes and duties levied on them. Estimates are made for unreported, or pipeline, premiums representing amounts due to the Group not yet notified. Outward reinsurance premiums are accounted for in the same accounting year as the premiums for the related inwards business.

b. Unearned premiums

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/risk profile basis.

c. Acquisition costs

Acquisition costs, which represent commission and other related expenses, are deferred over the period in which the related premiums are earned.

d. Claims incurred

Claims incurred comprise of claims and related expenses paid in the year and changes in the provisions for outstanding claims, including provisions for claims incurred but not reported and related loss adjustment expenses, together with any other adjustments to claims for previous years. Where applicable, deductions are made for salvage and other recoveries.

e. Claims provisions and related reinsurance recoveries

A provision is made at the year-end for the estimated cost of claims incurred but not settled at the balance sheet date, including the cost of claims incurred but not yet reported to the Group. The estimated cost of claims includes expenses to be incurred in settling claims and deduction for expected value of salvage and other recoveries. The Group takes all reasonable steps to ensure that it has appropriate information regarding its claims exposures. However, given the uncertainty in establishing claims provisions, it is likely that the final outcome will prove to be different from the original liability established. Gross loss provisions are calculated gross of any reinsurance recoveries.

The estimate of claims incurred but not reported ('IBNR') is generally subject to a greater degree of uncertainty than the estimate of the cost of settling claims already notified to the Group, where more information about a claim event is generally available. Claims IBNR may not become known to the insurer until many years after the event giving rise to the claim. Classes of business where the IBNR proportion of the total reserve is high will typically display greater variations between initial estimates and final outcomes because of the greater degree of difficulty of estimating these reserves. Classes of business where claims are typically reported relatively quickly after the event tend to display lower levels of volatility. In calculating the estimated cost of unpaid claims the Group uses a variety of estimation techniques, generally based upon statistical analyses of historical experience, which assumes that the development pattern of the current claims will be consistent with past experience. Allowance is made for changes or uncertainties which may create distortions in the underlying statistics or which might cause the cost of unsettled claims to increase or reduce when compared with the cost of previously settled claims including:

- changes in the Group's processes which might accelerate or slow down the development and/ or recording of paid or incurred claims compared with the statistics from previous periods;
- changes in the legal environment;
- the effects of inflation;
- changes in the mix of business;
- the impact of large losses; and
- movements in industry benchmarks.

A component of these estimation techniques is usually the estimation of the cost of notified but not paid claims. In estimating the cost of these, the Group has regard to the claim circumstance as reported, any information available from loss adjusters and information on the cost of settling claims with similar characteristics in previous periods.

Large claims impacting each relevant business class are generally assessed separately, being measured on a case by case basis and projected separately, in order to allow for the possible distortive effect of the development and incidence of these large claims.

Where possible, the Group adopts multiple techniques to estimate the required level of provisions. This assists in giving greater understanding of the trends inherent in the data being projected. The projections given by the various methodologies also assist in setting the range of possible outcomes. The most appropriate estimation technique is selected taking into account the characteristics of the business class and the extent of the development of each accident year.

Credit and Surety, London Market and Other Business

The majority of this business is "short tail", that is, where claims are usually made during the term of the policy or shortly after the policy has expired. The cost of claims notified to the Group at the balance sheet date is estimated on a case-by-case basis to reflect the individual circumstances of each claim. The ultimate expected cost of claims is projected from this data by reference to statistics which show how estimates of claims incurred in previous years have developed over time to reflect changes in the underlying estimates of the cost of notified claims and late notifications.

Professional Risks and Financial Lines

These claims are longer tail than those of the other classes of business described above and so a larger element of the claims provision relates to IBNR. Claims estimates for the Group's Professional Risks and Financial Lines businesses, as with other lines, are derived initially from a combination of loss ratio based estimates followed after a period of time reflecting the longer tail by estimates based upon actual claims experience. Alternative projection methods may be employed. The initial estimate of the loss ratio is based on the experience of previous years, adjusted for factors such as premium rate changes, claims inflation and market environment. The estimate of claims inflation and anticipated market environment is particularly sensitive to the level of court awards and to the development of legal precedent on matters of contract.

f. Reinsurance

Reinsurance to cover catastrophe exposed lines or lines with unbalanced line size to premium is purchased on a shared basis for the international insurance entities. Reinsurance premiums on excess of loss programmes are allocated across the International platforms based on gross premiums written. Reinsurance recoveries are allocated based on the share of gross losses suffered by each carrier. Purchases of the shared reinsurance programme are advised to both Lloyd's and the PRA. Additionally, the Group purchases quota share reinsurance to balance line size and premium where it is prudent to do so.

The reinsurers' share of claims incurred in the profit and loss account reflects the amounts received or receivable from reinsurers in respect of those claims incurred during the year. Reinsurance liabilities are primarily premiums payable for reinsurance contracts and are recognised in the Profit and Loss Account as "outwards reinsurance premiums".

g. Unexpired risks provision

Provisions are made for any deficiencies arising when unearned premiums, net of associated acquisition costs, are insufficient to meet expected claims and expenses after taking into account future investment return on the investments supporting the unearned premiums provision and unexpired risks provision. The expected claims are calculated based on information available at the balance sheet date.

Unexpired risks surpluses and deficits are offset where business classes are managed together and a provision is made if an aggregate deficit arises. The unexpired risks provision would be included within 'Other technical provisions'.

Subrogation and salvage

Recoveries arising out of subrogation or salvage are estimated on a prudent basis and included within other debtors.

g. Exceptional items

The Group classifies charges or credits which are unusual and material as exceptional items separately on the profit and loss account in order to provide further understanding of the financial performance of the Group.

h. Taxation

Taxation expense for the period comprises current and deferred tax recognised in the year. Tax is recognised in the profit and loss account, except to the extent that it relates to items recognised in other comprehensive income or equity. In this case tax is also recognised in other comprehensive income or equity, respectively.

Current tax is the amount of income tax payable in respect of the taxable profit for the year or prior years. Tax is calculated on the basis of tax rates and laws that have been enacted or substantively enacted by the year end.

Deferred tax arises from timing differences that are differences between taxable profits and total comprehensive income as stated in the financial statements. These timing differences arise from the inclusion of income and expenses in tax assessments in periods different from those in which they are recognised in financial statements.

Deferred tax is recognised on all timing differences at the reporting date. Unrelieved tax losses and other deferred tax assets are only recognised when it is probable that they will be recovered against the reversal of deferred tax liabilities or other future taxable profits.

Deferred tax is measured using tax rates and laws that have been enacted or substantively enacted by the period end and that are expected to apply to the reversal of the timing difference.

i. Allocated investment return transferred from the non-technical account

This income represents the portion of the total net investment return that relates to assets which are held to cover the non-life technical provision and which are transferred from the non-technical account in order to better reflect the balance of the technical account relating to non-life business.

j. Business combinations and goodwill

Business combinations are accounted for by applying the purchase method.

The cost of a business combination is the fair value of the consideration given, liabilities incurred or assumed and of equity instruments issued plus the costs directly attributable to the business combination. Where control is achieved in stages the cost is the consideration at the date of each transaction.

Notes to the Consolidated Financial Statements continued

Contingent consideration is initially recognised at estimated amount where the consideration is probable and can be measured reliably. Where (i) the contingent consideration is not considered probable or cannot be reliably measured but subsequently becomes probable and measurable or (ii) contingent consideration previously measured is adjusted, the amounts are recognised as an adjustment to the cost of the business combination.

On acquisition of a business, fair values are attributed to the identifiable assets, liabilities and contingent liabilities unless the fair value cannot be measured reliably, in which case the value is incorporated in goodwill. Where the fair value of contingent liabilities cannot be reliably measured they are disclosed on the same basis as other contingent liabilities.

Goodwill recognised represents the excess of the fair value and directly attributable costs of the purchase consideration over the fair values to the Group's interest in the identifiable net assets, liabilities and contingent liabilities acquired.

Goodwill is amortised over its expected useful life. Goodwill is assessed for impairment when there are indicators of impairment and any impairment is charged to the income statement. Reversals of impairment are recognised when the reasons for the impairment no longer apply.

The Group's goodwill arose principally from the acquisition in 2018 of Qdos Holdings Limited and its subsidiary Qdos Broker and Underwriting Services Limited. The goodwill is $88.0m and will be amortised over 15 years. In addition, goodwill of $1.6m arose on the acquisition in 2006 of Manchester Dickson Holdings Limited and its subsidiaries (Note 13).

HCCII's goodwill arose from the purchase in 2006 of a book of Professional Indemnity business from a subsidiary of Manchester Dickson Holdings Limited and was capitalised at cost and is being amortised over its useful economic life on a straight line basis over fifteen years (see Note 26).

k. Intangible assets

Intangible assets are stated at cost less accumulated amortisation and accumulated impairment losses. Amortisation is calculated, using a straight-line method, to allocate the depreciable amount of the assets to their residual values over their estimated useful lives. Amortisation and any impairment expense are charged to other charges in the non-technical account. Intangible assets' residual values and useful lives are reviewed, and adjusted, if appropriate, at the end of each reporting period. The effect of any change is accounted for prospectively.

The Group's intangible assets arose from the acquisition of QDOS Holdings Limited in 2018 and from the acquisition of Manchester Dickson Holdings Limited and its subsidiaries in 2006 and totalled $30.9m and $21.6m, respectively. The intangibles assets are amortised over their useful economic lives on a straight line basis which has been estimated to be fifteen years.

l. Land and buildings held as investments

On a periodic basis, the directors consider the open market valuation of the Group's land and buildings held as an investment. Should the valuation fall below its cost, the deficit is written off as impairment through the profit and loss account.

Any aggregate surplus or deficit on revaluation of investment properties is taken to the non-technical account.

Revaluation gains on owner occupied properties are taken to other comprehensive income except to the extent that those gains reverse a revaluation loss on the same property that was previously recognised as expense. Revaluation losses on owner occupied properties are taken to other comprehensive income to the extent they reverse a previously recognised revaluation gain with any further loss recognised in the non-technical account.

m. Tangible assets

Tangible assets are stated at cost, or open market valuation, less accumulated depreciation and accumulated impairment expense/losses. Cost includes the original price, costs directly attributable to bringing the assets to its working condition for its intended use, dismantling and restoration costs.

Depreciation

Assets are depreciated from the time when they are available for use. Tangible assets are capitalised and depreciated on a straight line basis over their estimated useful lives as follows:

- Leasehold improvements 10%
- Computer equipment 33%
- Fixtures, fittings and office equipment 20%

Derecognition

Tangible assets are derecognised on disposal or when no future economic benefits are expected. On disposal, the difference between the net disposal proceeds and the carrying amount is recognised and included in 'Other operating charges/income' in the profit or loss account.

n. Impairment of non-financial assets

At each balance sheet date non-financial assets not carried at fair value are assessed to determine whether there is an indication that the asset may be impaired. If there is such an indication the recoverable amount of the asset is compared to the carrying amount of the asset with an impairment loss recognised through the profit and loss account.

The recoverable amount of the asset (or asset's cash generating unit) is the higher of the fair value less costs to sell and value in use. Value in use is defined as the present value of the future cash flows before interest and tax obtainable as a result of the asset's continued use. These cash flows are discounted using a pre-tax discount rate that represents the current market risk-free rate and the risks inherent in the asset.

If the recoverable amount of the asset (or asset's cash generating unit) is estimated to be lower than the carrying amount, the carrying amount is reduced to its recoverable amount. An impairment loss is recognised in the profit and loss account, unless the asset has been revalued when the amount is recognised in other comprehensive income to the extent of any previously recognised revaluation. Thereafter, any excess is recognised in profit and loss.

If an impairment loss is subsequently reversed, the carrying amount of the asset (or asset's cash generating unit) is increased to the revised estimate of its recoverable amount, but only to the extent that the revised carrying amount does not exceed the carrying amount that would have been determined (net of depreciation or amortisation) had no impairment loss been recognised in prior periods. A reversal of an impairment loss is recognised in the profit and loss account.

o. Investments in subsidiary undertakings – Company

Investments in subsidiary undertakings are stated in the balance sheet at fair value with changes in fair value recognised through the statement of other comprehensive income, or, if an impairment expense, through the profit and loss account.

p. Cash and cash equivalents

Cash and cash equivalents includes cash in hand, deposits held at call with banks, other short-term highly liquid investments with original maturities of three months or less and bank overdrafts. Bank overdrafts, when applicable, are shown within borrowings in current liabilities.

q. Provisions and contingencies

Provisions

Provisions are recognised when:

- the Group has a present legal or constructive obligation as a result of past events;
- it is probable that an outflow of resources will be required to settle the obligation; and
- the amount of the obligation can be estimated reliably.

Provisions are measured at the present value of the expenditure expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase due to the passage of time is recognised as a finance cost.

Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognised even if the likelihood of an outflow with respect to any one item included in the same class of obligations might be small. Provisions for levies are recognised on the occurrence of the event identified by legislation that triggers the obligation to pay the levy.

Contingencies

Contingent liabilities arise as a result of past events when:

(i) It is not probable that there will be an outflow of resources or that the amount cannot be reliably measured at the reporting date; or

(ii) When the existence will be confirmed by the occurrence or non-occurrence of uncertain future events not wholly within the Group's control.

Contingent liabilities are disclosed in the financial statements unless the probability of an outflow of resources is remote. Contingent assets are not recognised. Contingent assets are disclosed in the financial statements when an inflow of economic benefits is probable. Contingent assets stop being recognised as contingent at the point it is determined the benefit is virtually certain.

r. Financial instruments

The Group has adopted FRS 102 relating to fair value hierarchy disclosures and applied the recognition and measurement provisions of IAS 39 (as adopted for use in the EU) and the disclosure requirements of FRS 102 in respect of financial instruments.

s. Financial assets

The Group classifies its financial assets into the following categories:

- Shares and other variable yield securities and units in unit trusts – at fair value through profit or loss;
- Debt securities and other fixed-income securities – at fair value through profit or loss;
- Equity securities – at fair value through profit or loss; and
- Deposits with credit institutions – loans and receivables.
- Real Estate Investment Trust loans.

Management determines the classification of its investments at initial recognition and re-evaluates this at every reporting date.

Financial assets designated at fair value through profit and loss at inception are those that are managed and whose performance is evaluated on a fair value basis. Information about these financial assets is provided internally on a fair value basis to the Group's key management personnel. The Group's investment strategy is to invest in fixed and variable interest rate debt securities and units in unit trusts.

The fair values of financial instruments traded in active markets are based on quoted bid prices on the balance sheet date. A market is regarded as active if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency; and those prices represent actual and regularly occurring market transactions on an arm's length basis.

The fair values of financial instruments that are not traded in an active market (for example corporate bonds), are established by the directors using valuation techniques which seek to arrive at the price at which an orderly transaction would take place between market participants. Net gains or losses arising from changes in the fair value of financial assets at fair value through profit or loss are presented in the profit and loss account within

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'unrealised gains on investments' or 'unrealised losses on investments' in the period in which they arise.

The fair values of Real Estate Investment Trust loans are provided quarterly by the fund manager based on modelling earnings results of comparable property loan assets under current market conditions.

Deposits with credit institutions – Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than those that the Group intends to sell in the short term or that it has designated at fair value through profit or loss. When a financial liability is recognised initially it is measured at fair value plus transaction costs that are directly attributable to the acquisition or issue of the financial liability. Loans and receivables are subsequently measured at amortised cost using the effective interest rate method. Receivables arising from insurance contracts are also classified in this category and are reviewed for impairment as part of the impairment review of loans and receivables. This basis of valuation is viewed by the directors as having prudent regard to the likely realisable value.

t. Impairment of financial assets

For financial assets not at fair value, the Group assesses at each balance sheet date whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or group of financial assets is impaired and impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that have occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. Objective evidence that a financial asset or group of assets is impaired includes observable data that comes to the attention of the Group about the following events:

- significant financial difficulty of the issuer or debtor;
- a breach of contract such as a default or delinquency in payments;
- it becoming probable that the issuer or debtor will enter bankruptcy or other financial reorganisation;
- the disappearance of an active market for that financial asset because of financial difficulties; or
- observable data indicating that there is a measurable decrease in the estimated future cash flow from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the group, including:
  - adverse changes in the payment status of issuers or debtors in the group; or
  - national or local economic conditions that correlate with defaults on the assets in the Group.

The Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant. If the Group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, then it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

If there is objective evidence that an impairment loss has been incurred on loans and receivables, the amount of the loss is measured as the difference between the asset carrying amount and the present value of estimated future cash flows discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced and the amount of the loss is recognised in the profit and loss account for the period. As a practical expedient, the Group may measure impairment on the basis of an instrument's fair value using an observable market price.

For the purpose of a collective evaluation of impairment, financial assets are grouped on the basis of similar credit risk characteristics (i.e. on the basis of the Group's grading process that considers asset type, industry, geographical location, past-due status and other relevant factors). Those characteristics are relevant to the estimation of future cash flows for groups of such assets by being indicative of the issuer's ability to pay all amounts due under the contractual terms of the debt instrument being evaluated.

If in a subsequent period the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as improved credit rating), the previously recognised impairment loss is reversed through the profit and loss account for the period.

u. Financial liabilities

Creditors are financial liabilities and are recognised initially at fair value, net of directly attributable transaction costs. Long-term creditors are subsequently stated at amortised cost, using the effective interest method.

v. Investment return

Interest income is recognised using the effective interest rate method. Dividend income is recognised when the right to receive payment is established. Rental income and investment expenses are accounted for on an accruals basis.

Realised gains and losses on investments carried at fair value through profit and loss are calculated as the difference between net sales proceeds and purchase price. Movements in unrealised gains and losses on investments represent the difference between the fair value at the balance sheet date and their purchase price for their fair value at the last balance sheet date, together with the reversal of unrealised gains and losses recognised in earlier accounting periods in respect of investment disposals in the current period.

Investment return is initially recorded in the non-technical account. A transfer is made from the non-technical account to the technical account for the earned investment income and realised returns on investments supporting the insurance technical provisions and related shareholder's funds.

w. Share capital

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new ordinary shares or options are shown in equity as a deduction, net of tax, from the proceeds.

x. Distributions to equity holders

Dividends and other distributions to the Group's shareholders are recognised as a liability in the financial statements in the period in which the dividends and other distributions are approved by the shareholders and declared as payable. These amounts are recognised in the statement of changes in equity.

4. Critical accounting judgements and estimation uncertainty

Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

Significant judgements in applying the accounting policies

Estimation of the ultimate net claims incurred from the issuance of insurance contracts involves assumptions concerning the future, and the resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are addressed below.

i. The ultimate liability arising from claims made under insurance contracts

The estimate of the ultimate liability arising from claims made under insurance contracts is the Group's most critical accounting estimate. The carrying amount of the claims outstanding, net of reinsurance, is $527.4m (2017: $495.3m). There are many sources of uncertainty that need to be considered in the estimate of the liability that the Group will ultimately pay for such claims. The level of provision has been set on the basis of the information that is currently available, including potential outstanding loss advices, experience of development of similar claims, historical experience, case law and legislative and judicial actions.

The most significant assumptions made relate to the level of future claims, the level of future claims settlements and the legal interpretation of insurance policies. Whilst the directors consider that the gross provision for claims and the related reinsurance recoveries are fairly stated on the basis of the information currently available to them, the ultimate liability will vary as a result of subsequent information and events and may result in significant adjustments to the amount provided. Adjustments to the amounts of provision are reflected in the financial statements for the period in which the adjustments are made. The methods used and the estimates made are reviewed regularly. See Note 5.1 (iv) for loss development triangles.

ii. Fair value of financial instruments

The fair value of financial instruments traded in active markets is based on quoted bid prices at the balance sheet date.

If quoted prices are unavailable, observable prices for recent arm's length transactions for an identical asset are used to determine its fair value. The carrying value of these instruments is $1,096.4m (2017: $1,200.0m), see Note 5.5 for pricing basis. The Group uses its judgement to select a variety of methods and to make assumptions that are mainly based on market conditions existing at the end of each reporting period.

iii. Estimated impairment of goodwill and other intangible assets

In accordance with the accounting policy stated in Notes 3(j) and 3(k), goodwill and other intangibles assets are capitalised at cost and amortised over useful economic life on a straight-line basis. On an annual basis the directors consider whether there are any events or changes in circumstances which indicate that the carrying value of goodwill may not be recoverable. The carrying value of goodwill and other intangible assets is $87.1m (2017: $0.5m) and $38.7m (2017; $4.6m), respectively. Any decrease in value determined would affect the Group's financial position.

iv. Pipeline premium

The Group makes an estimate of premiums written during the year that have not yet been notified by the financial year end ('pipeline premiums') based on prior year experience and current year business volumes. The pipeline premium is booked as written and an assessment is made of the related unearned premium provision and an estimate of claims incurred but not reported in respect of the earned element. The pipeline premium included within net written premium is $86.2m (2017: $68.5m).

5. Risk management

The Group has identified the risks arising from its activities and has established policies and procedures to manage these risks in accordance with its risk appetite. The Group maintains a risk register and categorises its risks into six areas: Insurance; Strategic, Regulatory and Group; Market; Operational; Credit; and Liquidity. The sections below outline the Group's risk appetite and explain how it defines and manages each category of risk. The disclosures set out in this note have been presented at the Group level, since the Group disclosures materially represent that of the Company.

5.1 Insurance risk

The Group's insurance business assumes the risk of loss from persons or organisations that are themselves directly exposed to an underlying loss. Insurance risk arises from this risk transfer due to inherent uncertainties about the occurrence, amount and timing of insurance liabilities. The four key components of insurance risk are underwriting including delegated

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authorities, reinsurance purchasing, claims management and reserving.

Each element is considered below.

i. Underwriting risk

Underwriting risk relates to the potential claims arising from inadequate underwriting. There are four elements that apply to all insurance products offered by the Group:

- cycle risk – the risk that business is written without full knowledge as to the (in) adequacy of rates, terms and conditions;
- event risk – the risk that individual risk losses or catastrophes lead to claims that are higher than anticipated in plans and pricing;
- pricing risk – the risk that the level of expected loss is understated in the pricing process; and
- expense risk – the risk that the allowance for expenses and inflation in pricing is inadequate.

The Group manages and models these four elements in the following three categories; attritional claims, large claims and catastrophe events.

The Group's underwriting strategy is to seek a diverse and balanced portfolio of risks in order to limit the variability of outcomes. This is achieved by accepting a spread of business over time, segmented between different products, geographies and sizes.

To manage underwriting exposures, the Group has developed limits of authority and business plans which are binding upon all staff authorised to underwrite and are specific to underwriters, classes of business and industry.

These authority limits are enforced through a comprehensive sign-off process for underwriting transactions including an escalation process for all risks exceeding individual underwriters' authority limits. Exception reports are also run regularly to monitor compliance and a rigorous peer and external review process are in place.

Rate monitoring, including risk adjusted rate change and adequacy against benchmark rates, are recorded and reported.

The annual corporate budgeting process comprises a three year Plan which incorporates the Group's underwriting strategy by line of business and sets out the classes of business, the territories and the industry sectors in which business is to be written. The Plan is approved by the directors and monitored by the underwriting committees on a monthly basis.

Underwriters calculate premiums for risks written based on a range of criteria tailored specifically to each individual risk. These factors include, but are not limited to, the financial exposure, loss history, risk characteristics, limits, deductibles, terms and conditions and acquisition expenses using rating and other models.

The Group also recognises that insurance events are, by their nature, random and the actual number and size of events during any one year may vary from those estimated using established statistical techniques.

To address this, the Group sets out its risk appetite (expressed as Probable Maximum Loss estimates ('PML') and modelled return period events) in certain territories as well as a range of events such as natural catastrophes and specific scenarios which may result in large industry losses. The aggregate position and modelled loss scenarios are monitored at the time of underwriting a risk and reports are regularly produced to highlight the key aggregations to which the Group is exposed.

The Group uses a number of modelling tools to monitor its exposures against the agreed risk appetite set and to simulate catastrophe losses in order to measure the effectiveness of its reinsurance programmes. Stress and scenario tests are also run using these models.

One of the largest types of event exposure relates to natural catastrophe events such as windstorm or earthquake. Where possible, the Group measures geographic accumulations and uses its knowledge of the business, historical loss behaviour and commercial catastrophe modelling software to assess the expected range of losses at different return periods. Upon application of the reinsurance coverage purchased, the key gross and net exposures are calculated on the basis of extreme events at a range of return periods.

The Group's catastrophe risk appetite set by the directors is limited to a gross PML aggregate of no more than 200% of Capital and for a probability of gross catastrophe event exceeding 50% of Capital of less than 1%. Additionally, the appetite for non-modelled risk and other potential non-Natural Catastrophe perils is included within the Catastrophe appetites noted above.

ii. Reinsurance risk

Reinsurance risk arises where reinsurance contracts:

- do not perform as anticipated;
- result in coverage disputes; or
- prove inadequate in terms of the vertical or horizontal limits purchased.

Failure of a reinsurer to pay a valid claim is considered a credit risk which is detailed in the credit risk section. See Note 5.5.

The purchase of reinsurance is a key tool utilised to manage underwriting risk. The Group's reinsurance programme is comprised predominantly of excess of loss cover which may be over placed to protect against reinstatement costs. Prior to placement of the programme, it is modelled against significant historic and modelled events across the peak exposure areas. The programme is purchased on a class of business basis, modelling catastrophe, large and attritional losses separately.

Consideration is given to a number of factors when setting minimum retention including the Annual Aggregate Loss ('AAL') for catastrophe exposed lines. Where market opportunity allows, additional reinsurance is purchased. Quota share and facultative reinsurance is also utilised where considered appropriate. A TM HCC reinsurance approval group examines and approves all reinsurers to ensure that they possess suitable security. The Group's reinsurance team ensures that these guidelines are followed, undertakes the administration of reinsurance contracts and monitors and instigates the Group's responses to any erosion of the reinsurance programmes.

iii. Claims management risk

Claims management risk may arise within the Group in the event of inaccurate or incomplete case reserves and claims settlements, poor service quality or excessive claims handling costs. These risks may damage the Group's brand and undermine its ability to win and retain business or incur punitive damages. These risks can occur at any stage of the claim life cycle.

The Group's claims teams are focused on 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 business' broader interests. Prompt and accurate case reserves are set for all known claims liabilities, including provisions for expenses, as soon as a reliable estimate can be made of the claims liability.

iv. Reserving risk

Reserving risk occurs within the Group where established insurance liabilities are insufficient through inaccurate forecasting, or where there is inadequate allowance for expenses and reinsurance bad debts.

The objective of the Group's reserving policy is to produce accurate and reliable estimates that are consistent over time and across classes of business. The Group's reserving process is governed by the IBNR Committee, a subcommittee of the Board, which meets on a quarterly basis (more frequently if catastrophic events require). The membership of the IBNR Committee is comprised of executives, actuarial, claims and finance representatives.

A fundamental part of the reserving process involves information from and recommendations by each underwriting team for each underwriting year and reserving class of business. These estimates are compared to the actuarial estimates (described in further detail below) and management's best estimate of IBNR is recorded. It is the policy of the Group to carry, at a minimum, the actuarial best estimate. It is not unusual for management's best estimate to be higher than the actuarial best estimate.

The actuarial reserving team uses a range of recognised techniques to project current paid and incurred claims and monitors claim development patterns. This analysis is then supplemented by a variety of tools including back testing, scenario testing, sensitivity testing and stress testing.

Gross and net development triangles of the estimate of ultimate claim cost for claims notified in a given year are presented overleaf for the Group and Company and give an indication of the accuracy of the Group's estimation technique for claims payments. Data has been translated using 31 December 2018 foreign exchange rates throughout the triangle.

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Loss development triangles – GROSS Ultimate claims and cumulative payments	Accident year 2011 $'000	2012 $'000	2013 $'000	2014 $'000	2015 $'000	2016 $'000	2017 $'000	2018 $'000	Total $'000
End of reporting year	249,334	157,209	192,291	163,426	188,879	261,617	257,609	283,120	
– one year later	254,841	124,065	205,285	169,986	221,275	263,588	256,078		
– two years later	241,763	133,229	205,950	142,949	241,919	257,322			
– three years later	236,955	137,615	187,385	142,847	231,860				
– four years later	218,891	148,714	175,554	141,099					
– five years later	216,512	140,147	174,544						
– six years later	210,252	138,481							
– seven years later	206,378								
Current estimate of ultimate claims	206,378	138,481	174,544	141,099	231,860	257,322	256,078	283,120	
Cumulative payments to date	187,722	124,145	145,180	84,741	144,006	159,961	128,981	74,244	
Liability recognised in the balance sheet	18,656	14,336	29,364	56,358	87,854	97,361	127,097	208,876	639,902
Provision in respect of previous years									128,489
Total provision included in the balance sheet									**768,391**

Loss development triangles – NET Ultimate claims and cumulative payments	Accident year 2011 $'000	2012 $'000	2013 $'000	2014 $'000	2015 $'000	2016 $'000	2017 $'000	2018 $'000	Total $'000
End of reporting year	131,554	122,470	164,499	124,220	147,596	191,124	197,773	215,890	
– one year later	133,443	119,826	161,155	122,476	161,324	189,231	206,966		
– two years later	121,739	107,272	153,415	101,131	159,322	180,880			
– three years later	122,633	104,305	147,140	105,175	153,883				
– four years later	119,645	101,193	142,928	105,774					
– five years later	116,782	110,422	139,304						
– six years later	113,330	107,905							
– seven years later	111,135								
Current estimate of ultimate claims	111,135	107,905	139,304	105,774	153,883	180,880	206,966	215,890	
Cumulative payments to date	98,788	93,277	110,355	67,904	104,537	121,085	101,671	56,951	
Liability recognised in the balance sheet	12,347	14,628	28,949	37,870	49,346	59,795	105,295	158,939	467,169
Provision in respect of previous years									60,277
Total provision included in the balance sheet									**527,446**

5.2 Strategic, regulatory and group risk

The Group manages strategic, regulatory and group risks together. Each element is considered below:

i. Strategic risk

This is the risk that the Group's strategy is inappropriate or that the Group is unable to implement its strategy. Where an event exceeds the Group's strategic plan, this is escalated at the earliest opportunity through the Group's monitoring tools and governance structure.

On a day-to-day basis, the Group's management structure encourages organisational flexibility and adaptability, while ensuring that activities are appropriately coordinated and controlled. By focusing on the needs of their customers and demonstrating both progressive and responsive abilities, 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 low risk tolerance by aligning interests to ensure that routine activities, projects and other initiatives are implemented to benefit and protect resources of both local business segments and the Group as a whole.

ii. Regulatory risk

Regulatory risk is the risk arising from not complying with regulatory and legal requirements. The operations of the Group are subject to legal and regulatory requirements within the jurisdictions in which it operates and the Group's compliance function is responsible for ensuring that these requirements are adhered to. Regulatory risk includes capital management risk.

Capital management

The Group estimates its economic capital requirements using an internal model (the Economic Capital Model ('ECM')) which, the directors believe, is the most appropriate tool to determine the Group's medium term capital needs. However, the Group is currently outside of the PRA Internal Model Approval Process ('IMAP') and since 1 January 2016 has measured regulated capital requirement using the Standard Formula Solvency Capital Requirement ('SF SCR'). The Board has reviewed the SF SCR against the ECM and has concluded that the SF SCR is appropriate. The SF SCR is measured against the Group's Solvency II Available Assets to monitor its Solvency. Given the inherent volatility of the SF SCR and Solvency II Available Assets, the Group carries an amount in excess of the regulatory minimum. At 31 December 2018 Solvency II Available Assets are in excess of 200% of the regulatory minimum (2017 - 200%).

iii. Group risk

Group risk occurs where business units fail to consider the impact of other parts of a group on the Group, as well as the risks arising from these activities. There are two main components of group risk which are explained below.

a. Contagion

Contagion risk is the risk arising from actions of one part of a group which could adversely affect any other part of the group. The Group is a member of the TM Group and therefore may be impacted by the actions of any other group company. This risk is managed by operating with clear and open lines of communication across the group to ensure all group entities are well informed and working to common goals.

b. Reputation

Reputation risk is the risk of negative publicity as a result of the Tokio Marine group's contractual arrangements, customers, products, services and other activities. The Group's preference is to minimise reputation risks, but it is not possible or beneficial to avoid them, as the benefits of being part of the group brand are significant.

The Group considers reputation risk as an impact on all risk events in the Risk Register, but not as a risk in its own right.

5.3 Market risk

Market risk arises where the value of assets and liabilities or future cash flows change as a result of fluctuations in economic variables, such as movements in foreign exchange rates, interest rates and market prices. Managing investment risk as a whole is fundamental to the operation and development of the Group's investment strategy key to the investment of Group assets.

The investment strategy is developed by reference to an investment risk budget, which is reviewed annually by the directors as part of the overall risk budgeting framework of the business. In 2018, the investment risk budget was confirmed that the amount of an investment loss, at the 1-in-200 Tail Value at Risk (TVaR) level, would be no more than the Group's excess capital (above the regulatory minimum). This was the result of a complete investment strategy review carried out by the Group's Investment Managers, New England Asset Management Ltd as part of the Investment Committee's annual review of its risk appetite. The investment risk appetite for 2018 is consistent with 2017.

Investment strategy is consistent with this risk appetite and investment risk is monitored on an ongoing basis. The internal model includes an asset risk module, which uses an Economic Scenario Generator ('ESG') to create multiple simulations of financial conditions, to support stochastic analysis of investment risk. Internal model output is used to assess potential investment downsides, at different confidence levels, including '1 in 200' year event, which reflects Solvency II modelling requirements. In addition, the Group undertakes regular scenario tests (which look at shock events such as yield curve shifts, credit spread widening, or the repeat of historic events) to assess the impact of potential investment losses.

ESG outputs are regularly validated against actual market conditions, but (as noted above) the Group also uses a number of other qualitative measures to support the monitoring and management of investment risk.

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i. Foreign exchange risk

The Group's functional and reporting currency is the US Dollar and when possible the Group generally hedges currency monetary liabilities (excluding unearned premium and deferred acquisition costs) with assets in those same currencies. Excess assets are generally held in US Dollars. The effect of this on foreign exchange risk is that the Group is mainly exposed to revaluation FX gains/losses of unmatched non-US Dollar denominated positions.

The Group operates in six main currencies: US Dollars; Sterling; Canadian Dollars; Swiss Francs; Australian Dollars and Euros.

Transactions in all currencies are converted to the US Dollar functional currency on initial recognition with any balances on monetary items at the reporting date being translated at the US Dollar spot rate. The following table summarises the carrying value of total assets and total liabilities and net profit, converted to US Dollars, categorized by the Group's main currencies.

FX risk exposure 31 December 2018	AUD $ $'000	CAD $ $'000	CHF Fr $'000	EUR € $'000	GBP £ $'000	Subtotal $'000	USD $ $'000	Total $'000
Total assets	16,987	4,330	30,260	404,760	530,947	**987,284**	1,110,835	**2,098,119**
Total liabilities	**(24,331)**	**(140)**	**(27,698)**	**(434,043)**	**(598,547)**	**(1,084,759)**	**(258,372)**	**(1,343,131)**
Net assets	(7,344)	4,190	2,562	(29,283)	(67,600)	(97,475)	852,463	754,988
Net profit/(loss)	**8,130**	**(930)**	**(2,648)**	**19,142**	**5,497**	**29,191**	**45,029**	**74,220**

FX risk exposure 31 December 2017	AUD $ $'000	CAD $ $'000	CHF Fr $'000	EUR € $'000	GBP £ $'000	Subtotal $'000	USD $ $'000	Total $'000
Total assets	19,817	5,556	23,852	381,388	406,897	**837,510**	1,124,630	**1,962,140**
Total liabilities	(35,291)	(436)	(18,642)	(429,764)	(479,427)	**(963,560)**	(317,196)	**(1,280,756)**
Net assets	**(15,474)**	**5,120**	**5,210**	**(48,376)**	**(72,530)**	**(126,050)**	**807,434**	**681,384**
Net profit/(loss)	**(10,535)**	**3,565**	**(4,558)**	**(6,983)**	**861**	**(17,650)**	**72,354**	**54,704**

Sensitivity analysis

Fluctuations in the Group's operating currencies against US Dollars, with everything else staying the same, would result in a change to net profit after tax and net asset value. The table below gives an indication of the impact on net profit and net assets of a percentage change in the relative strength of the US Dollar against the value of the Australian Dollar, Canadian Dollar, Swiss Franc, the Euro, and Sterling, simultaneously.

FX risk exposure – sensitivity	Impact on profit after tax		Impact on net assets	
Change in exchange rate of Canadian Dollar, Australian Dollar, Swiss Franc, Euro and Sterling, relative to US Dollar	2018 $'000	2017 $'000	2018 $'000	2017 $'000
US Dollar weakens 30% against other currencies	8,757	2,775	(29,242)	(38,621)
US Dollar weakens 20% against other currencies	5,838	1,850	(19,495)	(25,748)
US Dollar weakens 10% against other currencies	2,919	925	(9,747)	(12,874)
US Dollar strengthens 10% against other currencies	(2,919)	(925)	9,747	12,874
US Dollar strengthens 20% against other currencies	(5,838)	(1,850)	19,495	25,748
US Dollar strengthens 30% against other currencies	(8,757)	(2,775)	29,242	38,621

ii. Interest rate risk

Some of the Group's financial instruments, including cash and certain financial assets at fair value, are exposed to movements in market interest rates.

The Group manages interest rate risk by investing primarily in short duration financial assets along with cash. The Investment Committee monitors the duration of these assets on a regular basis.

Changes in interest rates also impact the present values of estimated Group liabilities, which are used for solvency calculations. The Group's investment strategy reflects the nature of the Group's liabilities, and the combined market risk of investment assets and estimated liabilities is monitored and managed within specified limits.

The following table shows the average duration at the reporting date of the financial instruments that are exposed to movements in market interest rates. Duration is a commonly used measure of volatility and the Group believes this gives a better indication than maturity of the likely sensitivity of the Group's investment portfolio to changes in interest rates.

Investment and cash – duration 31 December 2018	<1 yr $'000	1-2 yrs $'000	2-3 yrs $'000	3-4 yrs $'000	4-5 yrs $'000	5-10 yrs $'000	>10 yrs $'000	N/A $'000	Total $'000
Variable yield securities	41,251	–	–	–	–	–	–	–	41,251
Debt securities	165,972	98,307	175,242	244,480	161,383	178,818	73,353	–	1,097,555
Other investments	–	–	–	–	–	–	–	39,808	39,808
Total other financial investments	**207,223**	**98,307**	**175,242**	**244,480**	**161,383**	**178,818**	**73,353**	**39,808**	**1,178,614**
Deposits from third parties	57,646	–	–	–	–	–	–	–	57,646
Cash at bank	85,786	–	–	–	–	–	–	–	85,786
Total	**350,655**	**98,307**	**175,242**	**244,480**	**161,383**	**178,818**	**73,353**	**39,808**	**1,322,046**

Investment and cash – duration 31 December 2017	<1 yr $'000	1-2 yrs $'000	2-3 yrs $'000	3-4 yrs $'000	4-5 yrs $'000	5-10 yrs $'000	>10 yrs $'000	N/A $'000	Total $'000
Variable yield securities	28,550	–	–	–	–	–	–	–	28,550
Debt securities	237,567	127,286	132,656	250,965	184,825	183,194	84,714	–	1,201,207
Other investments	–	–	–	–	–	–	–	–	–
Total other financial investments	**266,117**	**127,286**	**132,656**	**250,965**	**184,825**	**183,194**	**84,714**	**–**	**1,229,757**
Deposits from third parties	56,278	–	–	–	–	–	–	–	56,278
Cash at bank	53,493	–	–	–	–	–	–	–	53,493
Total	**375,888**	**127,286**	**132,656**	**250,965**	**184,825**	**183,194**	**84,714**	**–**	**1,339,528**

Notes to the Consolidated Financial Statements continued

Sensitivity analysis

Changes in interest yields, with all other variables constant, would result in changes in the market value of debt securities as well as subsequent interest receipts and payments. This would affect reported profits after tax and net assets as indicated in the table below:

Investments and cash – interest rate sensitivity	Impact on profit after tax		Impact on net assets	
Shift in yield (basis points)	2018 $'000	2017 $'000	2018 $'000	2017 $'000
100 basis point increase	(35,177)	(34,966)	(35,177)	(34,966)
50 basis point increase	(17,588)	(17,483)	(17,588)	(17,483)
50 basis point decrease	17,323	16,747	17,323	16,747
100 basis point decrease	34,646	33,495	34,646	33,495

5.4 Operational risk

Operational risk arises from the risk of losses due to inadequate or failed internal processes, people, systems, service providers or external events. Operational risk includes conduct risk.

The Group actively manages and minimises operational risks where appropriate. This is achieved by implementing and communicating guidelines and detailed procedures and controls to staff and other third parties. The Group regularly monitors the performance of its controls and adherence to procedures through the risk management reporting process. Key components of the Group's operational control environment include:

- modelling of operational risk exposure and scenario testing;
- management review of activities;
- documentation of policies and procedures;
- preventative and detective controls within key processes;
- contingency planning; and
- other systems controls.

Addressing conduct risk has always been treated as a priority irrespective of the regulatory emphasis on the selling of financial products, including insurance products, to consumers. The Group's primary objective is that all policyholders should receive fair treatment throughout the product lifecycle, which requires the effective management of conduct risk. However, conduct risk is not limited to the fair treatment of customers and the Group's Conduct Risk Policy broadly defines conduct risk as "...the risk that detriment is caused to the Group, our customers, clients or counterparties because of the inappropriate execution of our business activities."

The Group therefore seeks at all times to perform its business activities in a manner that is not only fair, honest and transparent but that also complies fully with applicable UK and International laws and regulations and internal policies and procedures. The Group ensures that this ethos is clearly communicated from the Board of directors downwards to all members of staff and oversight is provided throughout the governance structure, primarily by way of the Product Governance and Distribution Committee. Day-to-day responsibility for monitoring the fair treatment of customers and broader aspects of conduct risk resides with the International Compliance Department which undertakes scheduled reviews as part of a comprehensive Compliance Monitoring schedule.

5.5 Credit risk

Credit risk arises where counterparties fail to meet their financial obligations in full as they fall due. The primary sources of credit risk for the Group are:

- reinsurers – whereby reinsurers may fail to pay valid claims against a reinsurance contract held by the Group;
- brokers and coverholders – whereby counterparties fail to pass on premiums or claims collected or paid on behalf of the Group;
- investments – whereby issuer default results in the Group losing all or part of the value of a financial instrument; and
- financial institutions holding cash.

The Group's core business is to accept insurance risk and the appetite for other risks is low. This protects The Group's solvency from erosion from non-insurance risks so that it can meet its insurance liabilities.

The Group limits exposure to a single counterparty or a group of counterparties and analyses the geographical locations of exposures when assessing credit risk.

An approval system exists for all new brokers and coverholders and their performance is carefully monitored. Regular exception reports highlight trading with non-approved brokers, and the Group's credit control function frequently assesses the ageing and collectability of debtor balances. Any large aged items are prioritised and where collection is outsourced incentives are in place to support these priorities.

The Investment Committee has established comprehensive guidelines for the Group's Investment Managers regarding the type, duration and quality of investments acceptable to the Group to ensure credit risk relating to the investment portfolio is kept to a minimum. The performance of the Group's Investment Managers is regularly reviewed to confirm adherence to these guidelines.

The Group has developed processes to formally examine all reinsurers before entering into new business arrangements. New reinsurers are approved by the reinsurance approval group, which also reviews arrangements with all existing reinsurers at least annually. Vulnerable or slow-paying reinsurers are examined more frequently. To assist in the understanding of credit risks, A.M. Best, Moody's and Standard & Poor's ('S&P') ratings are used. The Group's concentrations of credit risk have been categorised by these ratings in the following table.

Investment and cash – credit ratings 31 December 2018	AAA $'000	AA $'000	A $'000	BBB $'000	BB $'000	Not rated $'000	Total $'000
Variable yield securities	41,251	–	–	–	–	–	41,251
Debt securities	75,477	551,530	313,810	153,176	3,562	–	1,097,555
Other investments	–	–	–	–	–	39,808	39,808
Total other financial investments	**116,728**	**551,530**	**313,810**	**153,176**	**3,562**	**39,808**	**1,178,614**
Cash at bank	85,786	–	–	–	–	–	85,786
Total	**202,514**	**551,530**	**313,810**	**153,176**	**3,562**	**39,808**	**1,264,400**

Investment and cash – credit ratings 31 December 2017	AAA $'000	AA $'000	A $'000	BBB $'000	BB $'000	Not rated $'000	Total $'000
Variable yield securities	28,550	–	–	–	–	–	28,550
Debt securities	104,505	594,652	340,879	149,752	11,419	–	1,201,207
Other investments	–	–	–	–	–	–	–
Total other financial investments	**133,055**	**594,652**	**340,879**	**149,752**	**11,419**	–	**1,229,757**
Cash at bank	53,493	–	–	–	–	–	53,493
Total	**186,548**	**594,652**	**340,879**	**149,752**	**11,419**	–	**1,283,250**

The Group's largest counterparty exposure is $276.2m of US Government securities (2017: $275.9m). Insurance receivables and other receivable balances held by the Group have not been impaired based on available evidence and no impairment provision has been recognised in respect of these assets.

Notes to the Consolidated Financial Statements continued

An ageing analysis of the Group's insurance and reinsurance receivables that are past due at the reporting date is presented below:

Financial assets – ageing 31 December 2018	Not yet due $'000	Up to 3 months past due $'000	3 to 6 months past due $'000	7 to 12 months past due $'000	>1 year past due $'000	Total $'000
Reinsurers share of claims outstanding	240,945	–	–	–	–	240,945
Insurance debtors	115,177	11,288	4,175	–	–	130,640
Reinsurance debtors	51,468	15,111	9,742	6,132	–	82,453
Other debtors	34,671	–	–	–	–	34,671
Total	**442,261**	**26,399**	**13,917**	**6,132**	**–**	**488,709**

Financial assets – ageing 31 December 2017	Not yet due $'000	Up to 3 months past due $'000	3 to 6 months past due $'000	7 to 12 months past due $'000	>1 year past due $'000	Total $'000
Reinsurers share of claims outstanding	289,504	–	–	–	–	289,504
Insurance debtors	91,210	7,518	8,777	476	–	107,981
Reinsurance debtors	35,165	8,993	4,460	4,275	–	52,892
Other debtors	25,609	–	–	–	–	25,609
Total	**441,488**	**16,511**	**13,237**	**4,751**	**–**	**475,986**

Fair value estimation

The following table presents the Group's financial investments measured at fair value at 31 December 2018 and 31 December 2017 categorised into levels 1, 2 and 3, reflecting the categorization criteria specified in FRS 102 (s34.22). No liabilities were measured at fair value at 31 December 2018 or 31 December 2017.

Financial investments – pricing basis 31 December 2018	Level 1 $'000	Level 2 $'000	Level 3 $'000	Total $'000
Variable yield securities	–	41,251	–	41,251
Debt securities	1,189	1,096,366	–	1,097,555
Other investments	–	–	39,808	39,808
Total other financial investments	**1,189**	**1,137,617**	**39,808**	**1,178,614**

Financial investments – pricing basis 31 December 2017	Level 1 $'000	Level 2 $'000	Level 3 $'000	Total $'000
Variable yield securities	–	28,550	–	28,550
Debt securities	1,189	1,200,018	–	1,201,207
Other investments	–	–	–	–
Total other financial investments	**1,189**	**1,228,568**	**–**	**1,229,757**

FRS 102 defines the disclosure of investments levels as follows:

- Level 1 – Inputs are based on quoted prices in active markets for identical instruments;

The Group's Level 1 investments consist of U.S. Treasuries, money market funds and equity securities traded in an active exchange market. The Group uses unadjusted quoted prices for identical instruments to measure fair value.

- Level 2 – Inputs are based on observable market data (other than quoted prices) or are derived from or corroborated by observable market data;

The Group's Level 2 investments include most of its fixed maturity securities, which consist of U.S. government agency securities, foreign government securities, municipal bonds (including those held as restricted securities), corporate debt securities, bank loans, middle market senior loans, foreign debt securities, mortgage-backed and asset-backed securities (including collateralized loan obligations). The Group measures fair value for the majority of its Level 2 investments using matrix pricing and observable market data, including benchmark securities or yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, bids, offers, default rates, loss severity and other economic measures. The Group measures fair value for its structured securities using observable market data in cash flow models.

The Group is responsible for the prices used in its fair value measurements. The Group uses independent pricing services to assist itself in determining fair value of all of its Level 2 investments. The pricing services provide a single price or quote per security. The Group uses data provided by the Group's third party investment managers to value the remaining Level 2 investments. To validate that these quoted prices are reasonable estimates of fair value, the Group performs various quantitative and qualitative procedures, including:

1) evaluation of the underlying methodologies;
2) analysis of recent sales activity;
3) analytical review of the Group's fair values against current market prices; and
4) comparison of the pricing services' fair value to other pricing services' fair value for the same investment.

No markets for the Group's investments were judged to be inactive at period end. Based on these procedures, the Group did not adjust the prices or quotes provided by its independent pricing services, third party investment managers as of 31 December 2018 or at 31 December 2017.

- Level 3 – use of a valuation technique where there is no active market of other transactions which is a good estimate of fair value.

These comprise financial instruments where it is determined that there is no active market or that the application of criteria to demonstrate such are Level 2 securities is impractical. That fair value is established through the use of a valuation technique which incorporates relevant information to reflect appropriate adjustments for credit and liquidity risks and maximise the use of observable market data where it is available and rely as little as possible on entity specific estimates. The relative weightings given to differing sources of information and the determination of non-observable inputs to valuation models can require the exercise of significant judgement. The Group has Level 3 securities in the form of investment in a private equity fund. The private equity fund is carried at net asset value. Changes in the net asset value are included in investment income.

Notes to the Consolidated Financial Statements continued

5.6 Liquidity risk

Liquidity risk arises where cash may not be available to pay obligations when due at a reasonable cost. The Group is exposed to daily calls on its available cash resources, principally from claims arising from its insurance business. In the majority of cases, these claims are settled from premiums received.

The Group's approach is to manage its liquidity position so that it can reasonably survive a significant individual or market loss event (details of the Group's management of its exposure to loss scenarios are provided in Note 5.1.(i). This means that the Group maintains sufficient liquid assets, or assets that can be readily converted into liquid assets at short notice, to meet expected cash flow requirements. The Group can also draw on group funds to bridge short-term cash flow requirements. The following table is an analysis of the net contractual cash flows based on all the liabilities held at 31 December 2018 and 2017:

Financial liabilities – projected cash flows 31 December 2018	Within 1 yr $'000	1-3 yrs $'000	3-5 yrs $'000	> 5 yrs $'000	Total $'000
Net claims outstanding	152,216	185,301	98,605	91,324	527,446
Creditors from direct insurance operations	13,320	–	–	–	13,320
Creditors from reinsurance operations	76,833	–	–	–	76,833
Other creditors	41,296	9,799	–	–	51,095
Total	**283,665**	**195,100**	**98,605**	**91,324**	**668,694**

Financial liabilities – projected cash flows 31 December 2017	Within 1 yr $'000	1-3 yrs $'000	3-5 yrs $'000	> 5 yrs $'000	Total $'000
Net claims outstanding	140,910	164,233	90,804	99,399	495,346
Creditors from direct insurance operations	11,313	–	–	–	11,313
Creditors from reinsurance operations	53,671	–	–	–	53,671
Other creditors	33,296	–	–	–	33,296
Total	**239,190**	**164,233**	**90,804**	**99,399**	**593,626**

The next two tables summarise the carrying amount at the reporting date of financial instruments analysed by maturity date.

Investment and cash – maturity 31 December 2018	Within 1 yr $'000	1-3 yrs $'000	3-5 yrs $'000	> 5 yrs $'000	N/A $'000	Total $'000
Variable yield securities	41,251	–	–	–	–	41,251
Debt securities	87,900	233,823	188,669	587,163	–	1,097,555
Other investments	–	–	–	–	39,808	39,808
Total other financial investments	**129,151**	**233,823**	**188,669**	**587,163**	**39,808**	**1,178,614**
Cash at bank	85,786	–	–	–	–	85,786
Total	**214,937**	**233,823**	**188,669**	**587,163**	**39,808**	**1,264,400**

Investment and cash – maturity 31 December 2017	Within 1 yr $'000	1-3 yrs $'000	3-5 yrs $'000	> 5 yrs $'000	N/A $'000	Total $'000
Variable yield securities	28,550	–	–	–	–	28,550
Debt securities	112,561	215,988	221,695	650,963	–	1,201,207
Other investments	–	–	–	–	–	–
Total other financial investments	**141,111**	**215,988**	**221,695**	**650,963**	**–**	**1,229,757**
Cash at bank	53,493	–	–	–	–	53,493
Total	**194,604**	**215,988**	**221,695**	**650,963**	**–**	**1,283,250**

6. Segmental information

(a) Underwriting result by class of business

2018	Gross premiums written $'000	Gross premiums earned $'000	Gross claims incurred $'000	Gross operating expenses $'000	Reinsurance balance $'000	Net underwriting result $'000
Direct insurance						
Accident and health	14,365	14,041	(7,516)	(5,610)	(2,308)	(1,393)
Credit, political risk and suretyship	174,158	173,731	(66,946)	(58,789)	(5,692)	42,304
Travel	1,005	4,519	(2,945)	(2,003)	(229)	(658)
Marine, aviation and transport	20,079	17,879	(4,886)	(5,810)	(6,419)	764
Miscellaneous	8,819	7,742	14,295	(4,036)	(11,984)	6,017
Third party liability	272,485	240,051	(134,961)	(93,884)	749	11,955
Total direct	490,911	457,963	(202,959)	(170,132)	(25,883)	58,989
Reinsurance acceptances	**166,558**	**157,195**	**(53,010)**	**(47,055)**	**(34,239)**	**22,891**
Total	657,469	615,158	(255,969)	(217,187)	(60,122)	81,880
Investment return						25,655
Other technical income						5,260
Technical account						**112,795**

2017	Gross premiums written $'000	Gross premiums earned $'000	Gross claims incurred $'000	Gross operating expenses $'000	Reinsurance balance $'000	Net underwriting result $'000
Direct insurance						
Accident and health	11,055	11,373	(3,124)	(5,055)	(1,977)	1,217
Credit, political risk and suretyship	170,939	162,325	(90,828)	(56,372)	1,834	16,959
Travel	20,430	22,316	(20,897)	(10,950)	(299)	(9,830)
Marine, aviation and transport	21,793	22,500	(2,936)	(7,199)	(13,590)	(1,225)
Miscellaneous	10,775	10,027	(12,799)	(4,487)	10,105	2,846
Third party liability	211,373	219,958	(108,046)	(86,898)	(5,827)	19,187
Total direct	446,365	448,499	(238,630)	(170,961)	(9,754)	29,154
Reinsurance acceptances	**116,743**	**113,746**	**(19,571)**	**(35,511)**	**(25,125)**	**33,539**
Total	563,108	562,245	(258,201)	(206,472)	(34,879)	62,693
Investment return						32,305
Other technical income						3,451
Technical account						**98,449**

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

Notes to the Consolidated Financial Statements continued

(b) Geographical location of underwriting operations

	Gross premiums written 2018 $'000	Gross premiums written 2017 $'000	Profit/(loss) before taxation 2018 $'000	Profit/(loss) before taxation 2017 $'000	Net assets 2018 $'000	Net assets 2017 $'000
United Kingdom	494,884	437,997	97,850	43,596	633,492	677,039
Rest of Europe	162,585	125,111	(7,393)	27,602	121,496	4,345
	657,469	563,108	90,457	71,198	754,988	681,384

(c) Geographical location of gross premiums written by destination

	2018 $'000	2017 $'000
United Kingdom	296,075	277,583
Rest of Europe	219,217	175,584
Rest of the World	142,177	109,941
	657,469	563,108

7. Investment return

	2018 $'000	2017 $'000
Investment income:		
Income from other financial investments	27,436	26,490
Gains on the realisation of financial investments excluding FX from revaluation	–	7,289
Losses on the realisation of financial investments excluding FX from revaluation	(370)	–
Investment management fees and charges	(1,411)	(1,474)
Earned investment income allocated to the general business technical account	**25,655**	**32,305**
Unrealised losses on financial investments excluding FX from revaluation	(18,888)	(457)
Bank interest receivable and similar income	364	152
Total Investment Return	7,131	32,000

The Group recorded $12.0m net foreign exchange losses in revaluation of the non-US Dollar investment portfolio (2017: $28.6m gains). Additionally, foreign exchange gains on revaluation of other non-USD Dollar monetary assets and liabilities totalled $21.3m (2017: $48.6m losses).

8. Net operating expenses

	2018 $'000	2017 $'000
Commission costs	142,404	125,719
Change in deferred acquisition costs (Note 22)	(8,629)	3,270
Reinsurance commissions and profit participation	(20,638)	(17,486)
Earned net acquisition costs	113,137	111,503
Administrative expenses	83,412	77,483
	196,549	188,986

Total commission written during the year in respect of direct insurance was $113.6m (2017: $105.0m).

Staff costs

All UK based staff are employed by HCC Service Company Inc. (UK branch), a fellow Tokio Marine HCC group subsidiary. The disclosures in the staff costs table below relate to underwriting and other direct staff only. The costs of staff providing central services to HCC International entities are allocated and recharged to the Group as a management fee. This staff information is not included in salary costs and average staff numbers as it is not practical to allocate them to the underlying entities to which the staff provide services.

Group	2018 $'000	2017 $'000
Wages and salaries	24,528	24,555
Social security costs	3,011	3,280
Other pension costs	1,643	1,520
	29,182	29,355

The average numbers of direct staff (excluding directors) working for the Group during the year were as follows:

	2018 $'000	2017 $'000
Underwriting	137	129
Claims	16	16
Administration and finance	47	38
	200	183

Notes to the Consolidated Financial Statements continued

Directors' emoluments

The compensation of executive directors attributable to HCCII is charged as a management fee and not included in staff costs

	2018 $'000	2017 $'000
Aggregate emoluments	4,598	4,363
Pension contributions	12	11
	4,610	4,374

Pension benefits are accruing to one director (2017: one) under the Group's defined contribution pension scheme.

Highest paid director	2018 $'000	2017 $'000
Aggregate emoluments	1,555	1,492
Pension contributions	–	–
	1,555	1,492

9. Auditors' remuneration

During the year, the Group obtained the following services (exclusive of VAT) from the Company's auditors, PricewaterhouseCoopers LLP, and this is detailed below:

	2018 $'000	2017 $'000
Fees payable for the audit of the Company and the consolidated financial statements	459	434
Fees payable to the Company's auditor for other services:		
- The audit of the Company's subsidiaries	114	–
- Audit-related assurance services	503	147
	1,076	581

Auditors' remuneration is paid by HCC Service Company Inc. (UK branch) and recharged as appropriate to the Company and its subsidiaries.

10. Other charges and other operating expenses

	2018 $'000	2017 $'000
Brexit transition costs	4,125	–
Corporate oversight costs	3,443	3,361
Service awards	2,064	1,991
Amortisation of goodwill (Note 13)	1,467	–
Amortisation of intangibles (Note 13)	2,059	1,545
	13,158	6,897

Brexit transition costs of $4.125m were incurred mainly as a result of the set-up of a new company and office in Luxembourg and also include IT system and other consultancy costs. Service awards are mainly payments made to key staff following the acquisition of Houston Casualty by Tokio Marine in 2015 as well as other accrued amounts under a long-term incentive scheme.

11. Other technical income

Other technical income comprises $3.9m (2017 $3.5m) for credit limit notification services conducted for Credit policyholders of HCCII by HCC Credit Services Limited. In addition commission and fee income from QDOS of $1.4m following the acquisition on 1 October 2018 has been included.

12. Tax on profit on ordinary activities

	2018 $'000	2017 $'000
UK Corporation tax at 19.00% (2017: 19.25%)		
Current tax on income for the year	20,162	21,591
Tax in respect of prior years	(3,521)	643
Current tax charge for the year	16,641	22,234
Deferred tax – origination and reversal of timing differences	(404)	(5,740)
Tax on profit on ordinary activities	16,237	16,494

The tax assessed for the year is lower (2017: higher) than the standard rate of corporation tax in the UK. The differences are explained below:

	2018 $'000	2017 $'000
Profit on ordinary activities before taxation	90,457	71,198
Tax on profit on ordinary activities at standard rate of 19.00% (2017: 19.25%)	17,187	13,705
Expenses not deductible for tax purposes	298	381
Amortisation of goodwill and intangibles	670	297
Foreign tax	1,572	741
Effect of foreign exchange	(456)	2,840
Tax in respect of prior years	(3,521)	(1,408)
Other	487	(62)
Tax on profit on ordinary activities	16,237	16,494

The calculation of deferred tax balances at the year-end takes into account the reduction in the UK main corporation tax rate from 19.0% to 17.0% that becomes effective from 1 April 2020.

Notes to the Consolidated Financial Statements continued

13. Goodwill and other intangible assets

	Goodwill $'000	Other intangible assets $'000	Total $'000
Cost			
At 1 January 2018	1,648	21,631	23,279
Acquisitions	88,020	36,168	124,188
At 31 December 2018	**89,668**	**57,799**	**147,467**
Accumulated amortisation			
At 1 January 2018	1,099	16,996	18,095
Charge for the year	1,467	2,059	3,526
At 31 December 2018	**2,566**	**19,055**	**21,621**
Net			
At 31 December 2018	**87,102**	**38,744**	**125,846**
At 31 December 2017	549	4,635	5,184

The Group has recognised goodwill and intangibles created on the acquisition of the Manchester Dickson Holdings Limited group of companies in 2006. The carrying values at the end of the year were $0.5m (2017 - $0.5m) and $3.1m (2017 4.6m). On 1 October 2018 the QDOS group of companies was acquired (Note 16). Goodwill and intangibles of $88.0m (£67.1m) and $30.9m (£23.5m) were created, respectively. The valuation of the intangible asset is based on management's estimate of future policy renewal income and on its valuation of the trade name acquired. The intangible has been increased for deferred tax by $5.3m to $36.2m because future amortisation will be disallowed for UK corporation tax. A deferred tax liability of $5.3m has also been recognised.

The directors have assessed the useful economic life of the both the goodwill and the intangibles as 15 years based on the period over which the value of the underlying business acquired is expected to exceed the values of the acquired identifiable net assets.

14. Land and buildings – Group and Company

	2018 $'000	2017 $'000
Leasehold land and buildings	239	239

The investment property, which consists of long leasehold industrial units, was reviewed at 31 December 2018 on an open market basis, using reasonable judgements and contemporary evidence available. The valuation of the property in these statements remains materially correct and no impairment is required. See Note 3(l).

15. Investment in subsidiary undertakings

Set out below are HCCII's subsidiaries, as at 31 December 2018, with details of the percentages of nominal value and voting rights held by HCCII and the Group.

Name	Principal activity	Class of shares	Effective %
HCCI Credit Services Limited	Information services	Ordinary	100%
Tokio Marine Europe S.A. (incorporated in Luxembourg)	Insurance company	Ordinary	100%
Qdos Broker and Underwriting Services Limited	Insurance intermediary	Ordinary	100%
QDOS Holdings Limited	Holding company	Ordinary	100%
HCC Diversificación y Soluciones S.L. (incorporated in Spain)	Administration services	Ordinary	100%

All subsidiary companies are directly held and are incorporated in England and Wales unless otherwise stated above. All subsidiaries are included within the consolidation.

16. Business combination

On 1 October 2018, the Group acquired 100% of the issued share capital of Qdos Holdings Limited and its subsidiary Qdos Broker and Underwriting Services Limited (an insurance intermediary) for consideration of $122.0m (£93.0m). The group has used acquisition accounting to account for the purchase.

The revenue from Qdos Broker and Underwriting Services Limited included in the consolidated statement of comprehensive income for 2018 was $1.4m. Qdos Broker and Underwriting Services Limited also contributed profit of $0.7m over the same period.

The following tables summarises the consideration paid by the group.

Consideration at 1 October 2018	$'000
Cash consideration	110,468
Contingent consideration at expected amount	11,495
	121,963
Deferred consideration	
Payable within one year	5,753
Payable after more than one year	9,799
	15,552

The deferred consideration comprises an amount of $4.4m that has been held back from the full payment of the contracted cash consideration. This amount is payable in 2020 following completion of the 2019 audited financial statements for Qdos Broker and Underwriting Services Limited. This balance attracts interest at 3.5%pa above Lloyds Bank Plc base lending rate. The deferred consideration also includes $11.2m (at the year-end exchange rate) which is an estimate of amounts payable under an earn-out arrangement which is based on growth in GWP and is capped at $13m (£10m). The deferred consideration on the earn-out is expected to be settled at $5.8m in 2019 and at $5.4m in 2020.

Notes to the Consolidated Financial Statements continued

The fair value of the acquired assets and liabilities assumed at the acquisition date are shown below.

Asset category	Net assets $'000
Assets	
Tangible assets	123
Insurance debtors	6,113
Other debtors	102
Cash at bank	1,746
Liabilities	
Insurance Creditors	(3,590)
Other Creditors	(45)
Tax creditor	(1,366)
Net Assets	**3,083**
Intangibles	30,860
Cost of acquisition	**121,963**
Goodwill arising on acquisition	**88,020**

QDOS has been a high quality intermediary for the Group's underwriting of SME contractor Professional Indemnity insurance for over ten years. The Group expects to safeguard the distribution of this product and reduce acquisition costs while generating additional GWP through other QBUS products.

17. Other financial investments

	Fair value 2018 $'000	Fair value 2017 $'000	Book cost 2018 $'000	Book cost 2017 $'000
Variable yield securities and units in unit trusts	41,251	28,550	41,251	28,550
Debt securities and other fixed-income securities	1,097,555	1,201,207	1,124,815	1,199,325
Other investments	39,808	–	39,736	–
	1,178,614	1,229,757	1,205,802	1,227,875

Debt securities and other fixed-income securities comprise listed investments. Other investments is an investment in a private equity fund. The private equity fund investment is carried at the net asset value of the fund. Changes in the net asset value are included in investment income.

18. Other debtors

	2018 $'000	2017 $'000
Claims funds	16,216	19,215
Other debtors	242	1,038
Amounts owed by group companies	18,213	5,356
	34,671	25,609

There are no debtors falling due after more than one year. Amounts owed by group undertakings are short-term, unsecured, interest free and have no fixed date of repayment.

19. Tangible assets

	Leasehold improvements $'000	Owner occupied Land and Buildings $'000	Computer equipment $'000	Fixtures, fittings and office equipment $'000	Total $'000
Book cost					
At 1 January 2018	**1,462**	**3,820**	**165**	**1,925**	**7,372**
Additions	50	28	5	100	183
At 31 December 2018	**1,512**	**3,848**	**170**	**2,025**	**7,555**
Accumulated depreciation					
At 1 January 2018	**1,443**	**962**	**165**	**1,867**	**4,437**
Charge for the year	23	88	5	10	126
At 31 December 2018	**1,466**	**1,050**	**170**	**1,877**	**4,563**
Net book value					
31 December 2018	**46**	**2,798**	**–**	**148**	**2,992**
31 December 2017	**19**	**2,858**	**–**	**58**	**2,935**

Land and buildings are occupied by the Group for its own use and are being depreciated over 50 years through June 2045.

Notes to the Consolidated Financial Statements continued

20. Called up share capital – Group and Company

Allotted, called up and fully paid Ordinary Shares	2018 Number of Shares	2018 $'000	2017 Number of Shares	2017 $'000
Balance brought forward:				
– Ordinary shares of £1 each	96,047,813	163,045	96,047,813	163,045
– Ordinary shares of $1 each	70,197,000	70,197	70,197,000	70,197
Balance carried forward	**166,244,813**	**233,242**	**166,244,813**	**233,242**

The £1 ordinary shares (2017: £1 ordinary shares) are translated to US dollars at the rates of exchange ruling on the dates the shares were issued. Dividends declared as payable in 2018 totalled $nil (2017: $nil).

21. Other creditors including taxation and social security

	2018 $'000	2017 $'000
Corporation tax	4,419	7,995
Net deferred tax liability	15,494	10,590
Other creditors	323	304
Deferred consideration	5,753	–
Amounts owed to affiliate companies	15,307	14,407
	41,296	**33,296**

Amounts owed to affiliate companies are short-term, unsecured, interest free and have no fixed date of repayment.

Net deferred tax liability	2018 $'000	2017 $'000
At 1 January – net deferred tax liability	10,590	16,345
Changes in accelerated capital allowances	(140)	238
Intangible asset	5,299	–
Deferred taxation of release of Equalisation provision	(3,047)	(3,609)
Technical reserves	2,555	(1,765)
Short-term timing differences	237	(686)
Change in UK corporation tax rate	–	67
At 31 December – net deferred tax liability	15,494	10,590

The net deferred tax liability consists of the following amounts:

	2018 $'000	2017 $'000
Accelerated capital allowances	256	396
Intangible assets	5,299	–
Technical reserves	790	(1,765)
Short-term timing differences	569	332
Deferred taxation for release of Equalisation provision	8,580	11,627
Net deferred tax liability	15,494	10,590

22. Technical provisions – Group and Company

	Provisions for unearned premiums	Claims outstanding – reported claims	Claims outstanding – incurred but not reported claims	Claims outstanding – Total	Deferred acquisition costs (1)	Net technical liabilities
Gross of reinsurance						
At 1 January 2018	306,236	352,149	432,702	784,851	75,071	1,016,016
Exchange adjustments	(14,234)	(13,148)	(12,694)	(25,842)	(2,902)	(37,174)
Movement in provision	42,311	52,978	(43,596)	9,382	8,629	43,064
At 31 December 2018	**334,313**	**391,979**	**376,412**	**768,391**	**80,798**	**1,021,906**
Reinsurance						
At 1 January 2018	54,611	135,430	154,074	289,504	9,934	334,181
Exchange adjustments	(3,088)	(3,549)	(3,294)	(6,843)	(496)	(9,435)
Movement in provision	17,526	4,105	(45,821)	(41,716)	6,846	(31,036)
At 31 December 2018	**69,049**	**135,986**	**104,959**	**240,945**	**16,284**	**293,710**
Net						
At 31 December 2018	**265,264**	**255,993**	**271,453**	**527,446**	**64,514**	**728,196**
At 31 December 2017	**251,625**	**216,719**	**278,628**	**495,347**	**65,137**	**681,835**

(1) Reinsurer's share of deferred acquisition costs is included in accruals and deferred income.

23. Reconciliation of profit before tax to net cash inflow from operating activities

	2018 $'000	2017 $'000
Profit before tax	90,457	71,198
Adjustments for:		
Interest received	(27,800)	(26,642)
Amortisation of goodwill	1,467	–
Amortisation of other intangibles	2,059	1,541
Depreciation of tangible fixed assets	126	66
Increase in debtors, prepayments and accrued income	(61,136)	(17,787)
Increase/(Decrease) in creditors, accruals and deferred income	44,163	(12,304)
Increase in net technical provisions	46,361	83,145
(Increase)/Decrease in deposits with ceding undertakings	(1,368)	1,453
Realised and unrealised investments losses/(gains)	19,258	(6,832)
Net proceeds on purchased and sales of financial investments	31,885	(112,730)
Other non-cash movements including foreign exchange gains and losses	(616)	822
Net cash Inflow from operating activities	144,856	(18,070)

Notes to the Consolidated Financial Statements continued

24. Commitments

a. Capital commitments

The Group and Company have commitments to subscribe into a private equity fund investment vehicle totalling $100m (2017: $nil). At the date of the balance sheet the Group and Company had invested $39.8m.

b. Operating lease commitments

The Group leases various, as a lessee offices, under operating lease agreements. The Group is required to give notice for the termination of these agreements. The lease expenditure charged to the consolidated profit and loss account during the year is $1.4m (2017:$1.3m).

The future aggregate minimum lease payments under the non-cancellable portion of the Group's operating leases are as follows:

	2018 $'000	2017 $'000
Not later than 1 year	2,519	2,385
Later than one year and not later than 5 years	9,279	9,533
Later than 5 years	3,140	5,110
	14,938	**17,028**

25. Related party transactions

Parental Guarantee

The Group benefit from a parental guarantee from Houston Casualty Company, a subsidiary of HCC Insurance Holdings, Inc., guaranteeing the payment of all policyholder obligations of HCC International in the event of HCC International being unable to pay.

Shared Reinsurance Programme

The Group shares a reinsurance programme with the other Tokio Marine HCC International entities. Reinsurance premiums and recoveries are pro-rated across Tokio Marine HCC International entities according to their respective underlying risks and claims experience. Cash settlements with respect to the shared reinsurance programme are cleared through HCCII and settled on a monthly basis with the appropriate entity. The table below represents the reinsurance premium settled by HCCII on behalf of related parties and the net receivable balance due to HCCII in relation to the shared reinsurance programme.

Related party	Nature of Contract	2018 Closing balance $'000	2017 Closing balance $'000
Houston Casualty Co London	Excess of loss and Quota share	14,739	2,201
Syndicate 4141	Excess of loss and Quota share	1,551	2,344
		16,290	4,545

Intra-group reinsurance contracts

The Group enters into a number of inwards and outwards reinsurance contracts with other Group companies. The tables below provide detail of the nature of the contracts, the premium and the closing balance.

Related party – inward reinsurance	Nature of Contract	2018 Gross premium $'000	2018 Closing balance $'000	2017 Gross premium $'000	2017 Closing balance $'000
Tokio Marine Insurance Singapore	Inwards reinsurance	4,036	609	1,028	46
Tokio Marine & Nichido Fire Insurance Co. Ltd.	Inwards reinsurance	2,282	2,317	7,993	–
Syndicate 4141	Inwards reinsurance	862	–	3,890	–
Tokio Marine Kiln Group Limited	Inwards reinsurance	–	–	34	–
		7,180	2,926	12,945	46

Related party – outward reinsurance	Nature of Contract	2018 RI premium $'000	2018 Closing balance $'000	2017 RI premium $'000	2017 Closing balance $'000
Tokio Marine & Nichido Fire Insurance Co. Ltd.	Outwards reinsurance	619	(393)	2,597	(1,281)
Tokio Millennium Re AG	Outwards reinsurance	3,630	(252)	3,486	(87)
Lloyd's Syndicate 510	Outwards reinsurance	1,391	(1,059)	2	–
Houston Casualty Company	Outwards reinsurance	1,481	114	1,740	(105)
Tolio Millennium Re UK	Outwards reinsurance	190	(165)	(31)	(74)
Tokio Marine Kiln Insurance Limited	Outwards reinsurance	172	(30)	–	–
		7,483	(1,785)	7,794	(1,547)

Agency commission

The Group delegates underwriting authorities to a number of agencies within the wider TMHD group for which it pays a commission. These are detailed in the table below.

Related party	Nature of Contract	2018 Commission $'000	2018 Closing balance $'000	2017 Commission $'000	2017 Closing balance $'000
HCC Global Financial Products S.L.	Underwriting agency	23,111	(2,223)	17,921	(3,056)
HCC Specialty Ltd	Underwriting agency	2,936	(2,155)	2,255	(447)
		26,047	(4,378)	20,176	(3,503)

Group services administration

The Group has entered into a shared services arrangement with HCC Service Company Inc. (UK Branch) for the provision of central administrative services. These are detailed in the table below.

Related party	Nature of Contract	2018 Expenses incurred $'000	2018 Closing balance $'000	2017 Expenses incurred $'000	2017 Closing balance $'000
HCC Service Company Inc. (UK branch)	Provision of central administrative services	46,011	(12,762)	42,295	(10,904)

Notes to the Consolidated Financial Statements continued

Other related party accounts

The following table shows the balances outstanding at the year end between the Group and fellow affiliates of the Tokio Marine Group. The balances have arisen in the normal course of business.

Related party	2018 $'000	2017 $'000
HCC Insurance Holdings, Inc.	–	(1)
HCC Service Company, Inc.	(63)	(54)
U.S. Specialty Insurance Co	53	1,429
NameCo (No. 808) Ltd.	1,174	(743)
HCC Reinsurance Company Ltd	–	51
HCC Underwriting Agency Ltd.	–	11
Radius Underwriting Ltd	(3)	3
Rattner Mackenzie Limited	(1,753)	(1,750)
HCC Re Agency	113	100
Total	**(479)**	**(954)**

Key management compensation

The key management of the Group are considered to be the statutory directors of the Company. Note 8, Net Operating Expenses, gives details of their compensation as directors of the Company.

26. Ultimate parent company and controlling party

The Group's ultimate parent company and controlling party is Tokio Marine Holdings, Inc. ('TMHD'). TMHD is incorporated in and its head office is located in Tokyo, Japan. Copies of the consolidated financial statements of TMHD can be obtained from its website at http://www.tokiomarinehd.com/en/ir/library/annual_report/.

HCCII's immediate parent company is Tokio Marine HCC Insurance Holdings (International) Limited which is incorporated in England and has a head office in 1 Aldgate, London, EC3N 1RE.

27. Post balance sheet events

As part of the Group's strategic plan for maintaining and growing its business following Brexit, effective 1 January 2019 HCCII transferred its European branch technical net assets to new branches of its subsidiary Tokio Marine Europe SA ("TME") which is domiciled in Luxembourg. The process has followed the Part VII transfer protocol in accordance with both UK and Luxembourg company law and has been approved by the Luxembourg regulator (Commissariat aux Assurances). The Group's affiliate company Tokio Marine Kiln Insurance Limited also made a Part VII transfer to TME in January 2019. At the same time significant retrospective quota share reinsurance arrangements were applied to cede balances back to the transferring companies as shown in the table below. Investment assets equal to the net liabilities transferred by each company were contributed to TME after allowing for both the immediate impact of the retrospective quota shares and the accompanying ceding commission income.

The table below is the estimated book value of the net assets being transferred.

	TMKI $'000	HCCII $'000	Total $'000
Provision for unearned premium (net of reinsurers' share)	(26,383)	(55,299)	(81,682)
Claims outstanding (net of reinsurers' share)	(113,505)	(173,302)	(286,807)
Creditors arising out of direct and reinsurance operations	(31,797)	(42,615)	(74,412)
Deferred acquisition costs (net of reinsurers' share)	1,895	20,500	22,395
Debtors arising out of direct and reinsurance operations	63,335	46,096	46,096
Deposits from third parties	–	(21,210)	42,125
Cash, Investments and other assets	106,455	225,830	332,285
Value of Contribution in Kind	**$1 share**	**$1 share**	**$2 shares**

Company Financial Statements

Company Balance Sheet

	Note	2018 $'000	2017 $'000
ASSETS			
Intangible assets			
Goodwill	29	4,635	6,566
Investments			
Land and buildings	14	239	239
Investment in subsidiary undertakings	30	248,051	3,061
Other financial investments	31	1,057,900	1,229,757
		1,306,190	1,233,057
Reinsurers' share of technical provisions			
Provision for unearned premiums	22	69,049	54,611
Claims outstanding	22	240,945	289,504
		309,994	344,115
Debtors			
Debtors arising out of direct insurance operations			
– Policyholders		34,049	32,216
– Intermediaries		89,805	74,926
Debtors arising out of reinsurance operations		82,453	53,035
Other debtors	32	34,387	26,081
		240,694	186,258
Other assets			
Tangible assets	33	2,872	2,916
Deposits from third parties		57,646	56,356
Cash at bank and in hand		82,153	52,602
		142,671	111,874
Prepayments and accrued income			
Accrued interest and rent		7,655	8,586
Deferred acquisition costs	22	80,798	75,071
		88,453	83,657
Total assets		2,092,637	1,965,527

Company Financial Statements continued

Company Balance Sheet

	Note	2018 $'000	2017 $'000
LIABILITIES			
Capital and reserves			
Called up share capital	20	233,242	233,242
Revaluation reserve		6,042	3,062
Profit and loss account		519,302	446,825
Total shareholders' funds		758,586	683,129
Technical provisions			
Provision for unearned premiums	22	334,313	306,236
Claims outstanding	22	768,391	784,851
		1,102,704	1,091,087
Creditors – amounts due within one year			
Creditors arising out of direct insurance operations		9,008	11,313
Creditors arising out of reinsurance operations		76,833	52,773
Other creditors including taxation and social security	34	36,664	35,834
Deposits from third parties		57,721	56,356
		180,226	156,276
Creditors – amounts due after more than one year			
Deferred consideration	16	9,799	–
Accruals and deferred income		41,322	35,035
Total liabilities		2,092,637	1,965,527

In accordance with the exemption permitted under section 408 of the Companies Act 2006, the Company profit or loss account, and Company statement of other comprehensive income are not presented as part of these financial statements. The Company's profit after taxation for the year was $72.5 million (2017: $61.3 million profit).

Company Statement of changes in shareholder's equity

Capital and reserves	Called up share capital $'000	Revaluation reserve $'000	Profit and loss account $'000	Total shareholders' equity $'000
At 1 January 2018	233,242	3,062	446,825	683,129
Profit for the financial year	–	–	72,477	72,477
Revaluation of subsidiary undertakings	–	2,980	–	2,980
Distribution from subsidiary undertakings	–	–	–	–
At 31 December 2018	233,242	6,042	519,302	758,586

Capital and reserves	Called up share capital $'000	Revaluation reserve $'000	Profit and loss account $'000	Total shareholders' equity $'000
At 1 January 2017	233,242	8,208	385,521	626,971
Profit for the financial year	–	–	61,304	61,304
Revaluation of subsidiary undertakings	–	2,876	–	2,876
Distribution from subsidiary undertakings	–	(8,022)	–	(8,022)
At 31 December 2017	233,242	3,062	446,825	683,129

Notes to the Company Financial Statements

28. Summary of significant accounting policies

The accounting policies that are used in preparation of these Company financial statements are consistent with the accounting policies used in the preparation of the consolidated financial statements of the Group as set out in those financial statements. This includes the Group policies on critical accounting judgements and key sources of estimation uncertainty.

The additional accounting policies that are specific to the separate financial statements of HCCII are set out below.

a. Basis of Preparation

The individual financial statements of the Company ('HCCII') have been prepared in compliance with United Kingdom Accounting Standards, including Financial Reporting Standard 102, ''The Financial Reporting Standard applicable in the United Kingdom and the Republic of Ireland'' ('FRS 102'), Financial Reporting Standard 103, "Insurance Contracts" ('FRS 103') and the Companies Act 2006.

In accordance with the exemption permitted under section 408 of the Companies Act 2006, the Company profit or loss account, and Company statement of other comprehensive income are not presented as part of these financial statements.

b. Exemptions for qualifying entities under FRS 102

As allowed by FRS 102, the Company has applied certain exemptions as follows:

i. From preparing a statement of cash flows, on the basis that it is a qualifying entity and the consolidated statement of cash flows, included in these financial statements, includes the Company's;

ii. Related party disclosures, and

iii. From disclosing key management personnel compensation, as required by FRS 102 paragraph 33.7.

c. Investments in subsidiary undertakings

Investments in subsidiary undertakings are stated in the balance sheet at fair value with changes in fair value recognised through the statement of other comprehensive income, or, if an impairment expense, through the profit and loss account.

29. Goodwill

	2018 $'000	2017 $'000
Cost		
At 1 January	23,176	23,176
At 31 December	23,176	23,176
Accumulated amortisation		
At 1 January	16,610	15,451
Amortisation charge for the year	1,931	1,159
At 31 December	18,541	16,610
Net book value		
At 31 December	4,635	6,566

The goodwill arose on the purchase of a book of Professional Indemnity business from a group company in 2006.

30. Investment in subsidiary undertakings

Set out below are HCCII's subsidiaries, as at 31 December 2018, with details of the percentages of nominal value and voting rights held by HCCII. The movement in the revaluation of subsidiary undertakings is summarised below:

	2018 $'000	2017 $'000
At 1 January	3,061	8,208
Distributions received from subsidiary undertakings	–	(8,022)
Acquisitions during the year	121,963	–
Investment in subsidiary undertaking	120,000	–
Revaluation of subsidiary undertakings	3,296	2,147
Foreign exchange impact on translation to closing rate	(269)	728
At 31 December	248,051	3,061

On 1 October 2018, HCCII acquired 100% of the issued share capital of Qdos Holdings Limited and its subsidiary Qdos Broker and Underwriting Services Limited (an insurance intermediary) for consideration of $122.0m (£93.0m). Deferred consideration of $15.6m has been recognised as part of the cost of investment.

HCCII invested $120m of share capital into its newly established subsidiary TME.

The directors believe that the carrying value of HCCII's investment in subsidiary undertakings is supported by the underlying net assets. Investment in subsidiary undertakings, as listed below, comprises its equity holdings at current net asset value, less any impairment.

Name	Principal activity	Class of shares	Effective %
HCCI Credit Services Limited	Information services	Ordinary	100%
Tokio Marine Europe S.A. (incorporated in Luxembourg)	Insurance company	Ordinary	100%
Qdos Broker and Underwriting Services Limited	Insurance intermediary	Ordinary	100%
QDOS Holdings Limited	Holding company	Ordinary	100%
HCC Diversificación y Soluciones S.L. (incorporated in Spain)	Administration services	Ordinary	100%

All subsidiary companies are directly held and are incorporated in England and Wales unless otherwise stated above.

Notes to the Company Financial Statements continued

31. Other financial investments

	Fair value		Book cost	
	2018 $'000	2017 $'000	2018 $'000	2017 $'000
Variable yield securities and units in unit trusts	29,242	28,550	29,242	28,550
Debt securities and other fixed-income securities	988,850	1,201,207	1,007,748	1,199,325
Other investments	39,808	–	39,736	–
	1,057,900	1,229,757	1,076,726	1,227,875

Debt securities and other fixed-income securities comprise listed investments. Other investments is an investment in a private equity fund. The private equity fund investment is carried at the net asset value of the fund. Changes in the net asset value are included in investment income.

32. Other debtors

	2018 $'000	2017 $'000
Claims funds	16,216	19,215
Other debtors	182	1,042
Amounts owed by group companies	17,989	5,824
	34,387	26,081

There are no debtors falling due after more than one year. Amounts owed by group undertakings are short-term, unsecured, interest free and have no fixed date of repayment.

33. Tangible assets

	Leasehold improvements $'000	Owner occupied Land and Buildings $'000	Computer equipment $'000	Fixtures, fittings and office equipment $'000	Total $'000
Book cost					
At 1 January 2018	**1,466**	**3,820**	**19**	**1,880**	**7,185**
Additions	–	28	–	24	52
At 31 December 2018	**1,466**	**3,848**	**19**	**1,904**	**7,237**
Accumulated depreciation					
At 1 January 2018	**1,466**	**962**	**19**	**1,822**	**4,269**
Charge for the year	–	87	–	9	96
At 31 December 2018	**1,466**	**1,049**	**19**	**1,831**	**4,365**
Net book value					
31 December 2018	**–**	**2,799**	**–**	**73**	**2,872**
31 December 2017	**–**	**2,858**	**–**	**58**	**2,916**

Land and buildings are occupied by the Company for its own use and are being depreciated over 50 years through June 2045.

34. Other creditors including taxation and social security

	2018 $'000	2017 $'000
Corporation tax	2,672	7,736
Deferred tax liability	10,122	10,605
Other creditors	283	296
Deferred consideration	5,753	–
Amounts owed by group companies	17,834	17,197
	36,664	35,834

Amounts owed to group companies are short-term, unsecured, interest free and have no fixed date of repayment.

Deferred tax liability	2018 $'000	2017 $'000
At 1 January – deferred tax liability	10,605	16,345
Changes in accelerated capital allowances	(161)	253
Deferred taxation of release of Equalisation provision	(3,047)	(3,609)
Technical reserves	2,555	(1,765)
Short-term timing differences	170	(686)
Change in UK corporation tax rate	–	67
At 31 December - deferred tax liability	10,122	10,605

The deferred tax liability consists of the following amounts:

	2018 $'000	2017 $'000
Accelerated capital allowances	250	411
Technical reserves	790	(1,765)
Short-term timing differences	502	332
Deferred taxation for release of Equalisation provision	8,580	11,627
Deferred tax liability	10,122	10,605

Instigating Change Instilling Trust

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