UK P&I CLUB

Group Solvency and Financial Condition Report

The United Kingdom Mutual Steam Ship Assurance Association (Bermuda) Limited

Year ended 20 February 2018

UK P&I CLUB IS MANAGED BY **THOMAS MILLER**

Contents

A. Summary 5
Directors' Statement 6
Auditors report 7
A.1. Business 12
A.2. Underwriting performance 13
A.3. Investment performance 15
A.4. Performance from other activities 15
A.5. Any other information 15
B. System of Governance 16
B.1. General Information on the System of Governance 16
B.1.1. Overview 16
B.1.1.1. Committee Structure 16
B.1.1.2. Key Functions 17
B.1.2. Remuneration 17
B.1.3. Related party transactions 17
B.1.4. Board remuneration 17
B.2. Fit and Proper Requirements 17
B.3. Risk Management System 18
B.4. Internal Control System 21
B.5. Internal Audit Function 22
B.6. Actuarial Function 22
B.7. Outsourcing 23
B.8. Any Other Information 23
C. Risk Profile 24
C.1. Underwriting Risk 24
C.2. Market Risk 25
C.3. Credit Risk 26
C.4. Liquidity Risk 27
C.5. Operational Risk 27
C.6. Other Material Risks 28
C.7. Any Other Information 28
D. Valuation for Solvency Purposes 29
D.1. Assets 29
D.2. Technical Provisions 30
D.3. Other liabilities 33
D.4. Alternative methods of valuation 33
D.5. Any other information 33
E. Capital Management 34
E.1. Own funds 34
E.2. Solvency Capital Requirement and Minimum Capital Requirement 35
E.3. Use of the duration-based equity risk sub-module in the calculation of the Solvency Capital Requirement 35

E.4. Differences between internal model used and the standard formula	35
E.5. Non-compliance with the Minimum Capital Requirement and non-compliance with the Solvency Capital Requirement	37
E.6. Any other information	37
Appendix: UKE Solo information	38
1. UKE Valuation for Solvency Purposes	38
1.1. UKE Assets	38
1.2. UKE Technical Provisions	38
1.3. UKE other liabilities	40
2. UKE Capital Management	41
2.1. UKE Own funds	41
2.2. UKE Solvency Capital Requirement and Minimum Capital Requirement	42

A. Summary

This Solvency and Financial Condition Report ("SFCR") covers the Business and Performance of The United Kingdom Mutual Steam Ship Assurance Association (Bermuda) Limited ("UKB") and The United Kingdom Mutual Assurance Association (Europe) Limited ("UKE"), which together are known as "the Group". It covers the System of Governance, Risk Profile, Valuation for Solvency Purposes and Capital Management.

The ultimate Administrative Body that has the responsibility for all of these matters is the UKB's Board of Directors, with the help of various governance and control functions that it has put in place to monitor and manage the business.

The Group's internal model has been approved for the calculation of the underwriting risk elements of the Solvency Capital Requirement ("SCR") with the remainder calculated using the standard formula.

For SCR purposes the Group's total eligible own funds stood at $694.4 million. This includes an allowance for the ancillary own funds available to the UKE as approved by UKE's regulator.

The Ancillary Own Funds ("AOF") available to UKE represents only the element of funds that would be retained within UKE in the event of a supplementary call. Although the balance of funds are payable to UKB, these are not incorporated within the Group's eligible own funds. The Group intends to apply for the full AOF allowance which, if approved, would increase tier 2 eligible own funds by $392 million.

Eligible own funds cover the SCR of $343.7 million (2017: $375.0 million) with a capital adequacy ratio of 202.1% (2017: 169.9%). The Minimum Capital Requirement ("MCR") is $30.9 million (2017: $40.4 million) leading to an MCR capital adequacy ratio of 2125% (2017: 1500.4%).

The Group restructured immediately following the year end. As a result, UKE has become the parent undertaking within the Group and UKB has become its subsidiary. This restructure has no impact on the Group's capital coverage. However, due to recognition of UKB capital in UKE, this has increased UKE (solo basis) eligible own funds by $447 million, capital coverage by $142 million and solvency ratio to 261%.

Directors' Statement

We acknowledge our responsibility for preparing the SFCR in all material respects in accordance with the PRA Rules and the Solvency II Regulations.

We are satisfied that:

a) throughout the financial year in question, the Group has complied in all material respects with the requirements of the PRA Rules and the Solvency II Regulations as applicable to the insurer; and

b) it is reasonable to believe that the Group has continued so to comply subsequently and will continue so to comply in future.

Director
For and on behalf of the United Kingdom Mutual Steam Ship Assurance Association (Bermuda) Limited
18 July 2018

Auditors' Report

Report of the external independent auditor to the Directors of the United Kingdom Mutual Steam Ship Assurance Association (Bermuda) ("UKB") pursuant to Rule 4.1 (2) of the External Audit Chapter of the PRA Rulebook applicable to Solvency II firms and the Directors of the United Kingdom Mutual Steam Ship Assurance Association (Europe) ("UKE"), together making up "the Group".

Report on the Audit of the relevant elements of the Group Solvency and Financial Condition Report

Opinion

Except as stated below, we have audited the following documents prepared by The Group as at 20 February 2018:

- The "Valuation for solvency purposes" and "Capital Management" sections of the Group Solvency and Financial Condition Report of The United Kingdom Mutual Steam Ship Assurance Association (Bermuda) Limited as at 20 February 2018, ("the Narrative Disclosures subject to audit"); and

- Group templates S.02.01.02, S.23.01.22, S32.01.22 ("the Group Templates subject to audit"); and

- UKE Company templates S.02.01.02, S17.01.02, S.23.01.01, S28.01.01 ("the Company Templates subject to audit").

The Narrative Disclosures subject to audit and the Templates subject to audit are collectively referred to as the "relevant elements of the Group Solvency and Financial Condition Report".

We are not required to audit, nor have we audited, and as a consequence do not express an opinion on the Other Information which comprises:

- Information contained within the relevant elements of the Group Solvency and Financial Condition Report set out about above which are, or derive from the Solvency Capital Requirement, as identified in the Appendix to this report;

- The "Business and performance", "System of governance" and "Risk profile" elements of the Group Solvency and Financial Condition Report;

- Group templates S05.01.02, S05.02.01, S.25.02.22, S.25.03.22;

- UKE Company templates S05.01.02, S05.02.01;

- The written acknowledgement by management of their responsibilities, including for the preparation of the Group Solvency and Financial Condition Report ("the Responsibility Statement"); and

- Information which pertains to an undertaking that is not a Solvency II undertaking and has been prepared in accordance with PRA rules other than those implementing the Solvency II Directive or in accordance with an EU instrument other than the Solvency II regulations, "the sectoral information".

To the extent the information subject to audit in the relevant elements of the Group Solvency and Financial Condition Report includes amounts that are totals, sub-totals or calculations derived from the Other Information, we have relied without verification on the Other Information.

In our opinion, the information subject to audit in the relevant elements of the Group Solvency and Financial Condition Report and the relevant templates of UKB and UKE as at 20 February 2018 is prepared, in all material respects, in accordance with the financial reporting provisions of the PRA Rules and Solvency II regulations on which they are based, as modified by relevant supervisory modifications, and as supplemented by supervisory approvals and determinations.

Basis for opinion
We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") including ISA (UK) 800 and ISA (UK) 805, and applicable law. Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the relevant elements of the Group Solvency and Financial Condition Report section of our report. We are independent of UKB and UKE in accordance with the ethical requirements that are relevant to our audit of the Group Solvency and Financial Condition Report in the UK, including the FRC's Ethical Standard as applied to public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Conclusions relating to going concern
We have nothing to report in respect of the following matters in relation to which the ISAs (UK) require us to report to you where:

- the Directors' use of the going concern basis of accounting in the preparation of the SFCR is not appropriate; or

- the Directors have not disclosed in the SFCR any identified material uncertainties that may cast significant doubt about the Group'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 SFCR is authorised for issue.

Emphasis of Matter – Basis of Accounting
We draw attention to the Valuation for solvency purposes, Capital Management and other relevant disclosures sections of the Group Solvency and Financial Condition Report, which describe the basis of accounting. The Group Solvency and Financial Condition Report is prepared in compliance with the financial reporting provisions of the PRA Rules and Solvency II regulations, and therefore in accordance with a special purpose financial reporting framework. The Solvency and Financial Condition Report is required to be published, and intended users include but are not limited to the Prudential Regulation Authority. As a result, the Group Solvency and Financial Condition Report may not be suitable for another purpose. Our opinion is not modified in respect of this matter.

Other Information
The Directors are responsible for the Other Information.

Our opinion on the relevant elements of the Group Solvency and Financial Condition Report does not cover the Other Information and we do not express an audit opinion or any form of assurance conclusion thereon.

In connection with our audit of the Group Solvency and Financial Condition Report, our responsibility is to read the Other Information and, in doing so, consider whether the Other Information is materially inconsistent with the relevant elements of the Group Solvency and Financial Condition Report, or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the relevant elements of the Solvency and Financial Condition Report 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 in this regard.

Responsibilities of Directors for the Group Solvency and Financial Condition Report
The Directors are responsible for the preparation of the Group Solvency and Financial Condition Report in accordance with the financial reporting provisions of the PRA rules and Solvency II regulations, which have been modified by the modifications, and supplemented by the approvals and determinations made by the PRA under section 138A of FSMA, the PRA Rules and Solvency II regulations on which they are based.

The Directors are also responsible for such internal control as they determine is necessary to enable the preparation of a Group Solvency and Financial Condition Report that is free from material misstatement, whether due to fraud or error.

Auditor's Responsibilities for the Audit of the relevant elements of the Group Solvency and Financial Condition Report

It is our responsibility to form an independent opinion as to whether the relevant elements of the Group Solvency and Financial Condition Report are prepared, in all material respects, with financial reporting provisions of the PRA Rules and Solvency II regulations on which they are based.

Our objectives are to obtain reasonable assurance about whether the relevant elements of the Group Solvency and Financial Condition Report are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but it 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 decision making or the judgement of the users taken on the basis of the Group Solvency and Financial Condition Report.

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at:
https://www.frc.org.uk/auditors/audit-assurance/auditor-s-responsibilities-for-the-audit-of-the-fi/description-of-the-auditor%e2%80%99s-responsibilities-for

Other Matter

The Group and UKE have authority to calculate their Group Solvency Capital Requirement and Company Solvency Capital Requirement using a partial internal model ("the Model") approved by the Prudential Regulation Authority in accordance with the Solvency II Regulations. In forming our opinion (and in accordance with PRA Rules), we are not required to audit the inputs to, design of, operating effectiveness of and outputs from the Model, or whether the Model is being applied in accordance with the Group's or UKE's application or approval order.

Report on Other Legal and Regulatory Requirements

Sectoral Information

In our opinion, in accordance with Rule 4.2 of the External Audit Chapter of the PRA Rulebook, the sectoral information has been properly compiled in accordance with the PRA rules and EU instruments relating to that undertaking from information provided by members of the group and the relevant insurance group undertaking.

Other Information

In accordance with Rule 4.1 (3) of the External Audit Chapter of the PRA Rulebook for Solvency II firms we are also required to consider whether the Other Information is materially inconsistent with our knowledge obtained in the audit of the Group's and UKE's statutory financial statements. 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 in this regard.

Alexander Barnes (Senior Statutory Auditor)
For and on behalf of Moore Stephens LLP, Statutory Auditor
150 Aldersgate Street, London EC1A 4AB
19 July 2018

Appendix

Relevant elements of the Group Solvency and Financial Condition Report that are not subject to audit

Group internal model

The relevant elements of the Group Solvency and Financial Condition Report that are not subject to audit comprise:

- The following elements of Group template S.02.01.02:
  - Row R0550: Technical provisions – non-life (excluding health) – risk margin
  - Row R0590: Technical provisions – health (similar to non-life) – risk margin
  - Row R0640: Technical provisions – health (similar to life) – risk margin
  - Row R0680: Technical provisions – life (excluding health and index linked and unit-linked) – risk margin
  - Row R0720: Technical provisions – Index-linked and unit-linked – risk margin

- The following elements of Group template S.22.01.22:
  - Column C0030 – Impact of transitional on technical provisions
  - Row R0010 – Technical provisions
  - Row R0090 – Solvency Capital Requirement

- The following elements of Group template S.23.01.22:
  - Row R0020: Non-available called but not paid in ordinary share capital at group level
  - Row R0060: Non-available subordinated mutual member accounts at group level
  - Row R0080: Non-available surplus at group level
  - Row R0100: Non-available preference shares at group level Row R0120: Non-available share premium account related to preference shares at group level
  - Row R0150: Non-available subordinated liabilities at group level Row R0170: The amount equal to the value of net deferred tax assets not available at the group level
  - Row R0190: Non-available own funds related to other own funds items approved by supervisory authority
  - Row R0210: Non-available minority interests at group level Row R0380: Non-available ancillary own funds at group level Rows R0410 to R0440 – Own funds of other financial sectors Row R0680: Group SCR
  - Row R0740: Adjustment for restricted own fund items in respect of matching adjustment portfolios and ring-fenced funds
  - Row R0750: Other non-available own funds

- Elements of the Narrative Disclosures subject to audit identified as “unaudited”.

Appendix

Relevant elements of the Group Solvency and Financial Condition Report that are not subject to audit

Solo partial internal model
The relevant elements of the Solvency and Financial Condition Report that are not subject to audit comprise:

- The following elements of template S.02.01.02:
  - Row R0550: Technical provisions – non-life (excluding health) – risk margin
  - Row R0590: Technical provisions – health (similar to non-life) – risk margin
  - Row R0640: Technical provisions – health (similar to life) – risk margin
  - Row R0680: Technical provisions – life (excluding health and index linked and unit-linked) – risk margin
  - Row R0720: Technical provisions – Index-linked and unit-linked – risk margin

- The following elements of template S.12.01.02:
  - Row R0100: Technical provisions calculated as a sum of BE and RM – risk margin
  - Rows R0110 to R0130 – Amount of transitional measure on technical provisions

- The following elements of template S.17.01.02:
  - Row R0280: Technical provisions calculated as a sum of BE and RM – risk margin
  - Rows R0290 to R0310 – Amount of transitional measure on technical provisions

- The following elements of template S.22.01.21:
  - Column C0030 – Impact of transitional measure on technical provisions
  - Row R0010 – Technical provisions
  - Row R0090 – Solvency Capital Requirement

- The following elements of template S.23.01.01:
  - Row R0580: SCR
  - Row R0740: Adjustment for restricted own fund items in respect of matching adjustment portfolios and ring fenced funds

- The following elements of template [S.28.01.01 / S.28.02.01]:
  - Row R0310: SCR

- Elements of the Narrative Disclosures subject to audit identified as “unaudited”.

A1. Business

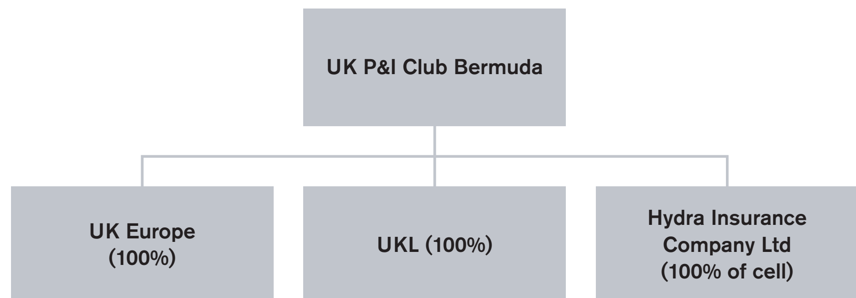
Corporate information
The United Kingdom Mutual Steam Ship Assurance Association (Bermuda) Limited ("UKB") is incorporated in Bermuda as a company limited by guarantee without share capital.

At the year-end date UKB was the parent company of the Group. The Group writes Marine Protection and Indemnity risks through its subsidiary undertaking, The United Kingdom Mutual Steam Ship Assurance Association (Europe) Limited ("UKE") which is registered in England and Wales as a company limited by guarantee without share capital.

UKB was the sole member of the UKE and therefore held all voting rights.

Group structure
Collectively these entities form "the Group". The Group structure, including all active companies, was as follows at the year-end date:

Table 1: The Group Structure for the 2017 policy year



The principal activity of the Group is the insurance and reinsurance of marine protection and indemnity risks on behalf of the Members.

The Group operates as a single business. All policies of insurance issued by the Group are written by UKE and all policyholders of UKE are Members of UKB. The policyholders therefore hold all voting rights of UKB and the Group.

UKE reinsures 90% of all premium income and claims incurred to the Group (net of external reinsurance).

Hydra Insurance Company operates through several segregated cells. One of these cells is controlled by the Group and all transactions of the cell are in respect of the Group's business. Therefore, that Hydra cell is consolidated into the results of the Group for the purposes of the IFRS financial statements.

Hydra provides reinsurance to the UKE for claims in excess of $30 million arising from mutual owned business.

Under Solvency II valuation requirements Hydra is treated as a third party reinsurer. Therefore the Group's interest in Hydra is not consolidated in the Solvency II balance sheet, but treated as an investment.

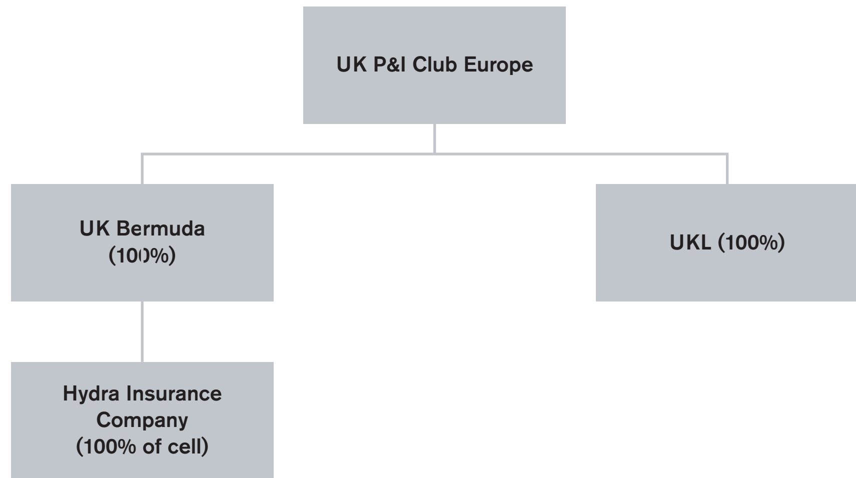
The United Kingdom Mutual Steam Ship Assurance Association (London) Limited ("UKL") ceased writing new business in 1971. All liabilities arising from business written by UKL are fully reinsured by UKE.

The Group has received a waiver from the PRA to present a single Group SFCR that incorporates the results of both the Group and UKE. The main part of this SFCR presents the Group results, unless otherwise stated. The results of UKE on a solo basis are detailed in appendix 1.

Group restructure
On 20 February 2018, immediately following the year end, the Group was restructured. As a result of the restructure, UKE became the holding company for the Group and the sole Member of UKB. UKE policyholders, who were previously Members of UKB, had their Membership rights transferred to UKE.

The Group structure applicable from the start of the 2018 policy year is therefore as follows:

Table 2: The Group Structure for the 2018 policy year



The activities of the individual companies have not been affected by the restructure.

Other information
The authority responsible for the financial supervision and review of the SFCR and RSR of the Group is the Prudential Regulatory Authority which is located at 20 Moorgate, London EC2R 6DA.

The Group is also regulated by the Bermuda Monetary Authority ("BMA") which is located 43 Victoria Street, Hamilton, HMJX Bermuda.

The external auditor of the Group is Moore Stephens LLP located at 150 Aldersgate Street, London, EC1A 4AB, United Kingdom.

A.2. Underwriting performance

Underwriting performance measures
The Group's target is to call sufficient premium to cover its claims and expenses as measured by the combined ratio. Since claims vary from one year to another, the Group considers performance against this target over the medium term by monitoring the average financial year combined ratio.

To achieve the combined ratio target, the Group focuses on disciplined underwriting based on appropriate risk selection as informed by a thorough understanding of risk.

The Group employs techniques such as programmes for loss prevention and efficient reinsurance purchase to manage the risk accepted.

S.05.02.01 includes a geographical split of the Group's business based on the country in which the Member is located.

The Group operates a single line of business: Protection and Indemnity insurance for the shipping community. The Group therefore reports all business within this single line and does not report additional analysis by business segment.

Recent Underwriting performance

The Group's target is to call sufficient premium to meet claims and expenses over the medium term. The average combined ratio over the last seven years is 99% (excluding supplementary calls and mutual premium discounts) and therefore the Group has met its underwriting target over the previous seven years. By achieving this target the Group has been able to discount mutual premium rates three times in the previous seven years. The total discount amounts to $25 million.

Table 3: Recent underwriting performance

Amounts in $000s	2018	2017
Income		
Gross earned premium	361,793	386,166
Mutual premium discount	–	(9,996)
	361,793	376,170
Premium ceded to reinsurers	(65,119)	(81,082)
Net earned premium	296,674	295,088
Net investment return	43, 161	51,774
Total net income	**339,835**	**346,862**
Expenses		
Claims and claims adjustment expenses net of reinsurance	(225,699)	(273,619)
Expenses for the acquisition of insurance contracts	(20,947)	(20,299)
Net operating expenses	(21,804)	(23,296)
Foreign exchange (losses)/gains	8,209	(7,715)
Total expenses	**(260,242)**	**(324,929)**
Results from operating activities	**79,593**	**21,933**

Total net premium income increased by $1.6 million to just below $297 million. The Group benefits from significant reinsurance cover.

The number of claims notified to the Group over the first 12 months' development of the 2017 policy year was lower than over the same period of development of the 2016 policy year. However, the Group's share of claims notified to the International Group Pool was higher than the very benign 2016 policy year. Of the 14 claims notified to the Pool, 3 were notified by the UK Club.

The total cost of the 2017 policy year is expected to be broadly similar to the 2016 policy year and consistent with the forecast cost set at the beginning of the year.

Total expenses were broadly in line with the previous year.

The overall surplus was transferred to reserves.

A.3. Investment performance

In accordance with the investment policy, the investment mandate is updated on a regular basis. The asset allocation established within the mandate is principally determined to ensure that future cash flows arising from liabilities (principally claims reserves) are matched by available assets of the correct currency and duration. Effective risk management is therefore the principal driver of investment allocation.

Having established a matched portfolio, limited investment risk is accepted to achieve the best return available from the surplus assets.

Some factors that may influence future investment return are:

- Market performance – as affected by macro-economic, political or other factors
- Capital allocation and risk profile – determining the risk accepted into the portfolio
- Portfolio management – including asset allocation (both strategic and tactical)

Asset allocation
The following table provides the breakdown of the investment portfolio.

Asset allocation within the Group
The investment portfolio includes investment in equities, government and corporate bonds. The total portfolio returned $43.2 million (prior year $51.8 million) (excluding currency losses) over the 2017/18 financial year. Investment returns per the IFRS financial statements are further detailed in the table below:

Table 4: Investment performance as disclosed within the financial statements

Amounts in $000s	**2018**	**2017**
Investment income		
Dividend income	20,874	8,692
Interest on fixed income securities	3,121	14,683
Bank deposit interest	443	72
Other investment charges	(9,837)	(6,782)
Total investment income	**14,601**	**16,665**
Net realised gains on financial assets at fair value through profit and loss		
Debt securities	(852)	(6,156)
Equity securities	20,550	14,400
Total net realised gains on financial assets	**19,698**	**8,244**
Net fair value gains on financial assets through profit and loss		
Debt securities	(1,222)	(8,652)
Equity securities	10,084	35,517
Total	**8,862**	**26,865**
Total investment return	**43,161**	**51,774**

A.4. Performance from other activities

As noted in A.2. all of the Group's activities relate to its core business.

A.5. Any other information

The Group does not consider that the disclosure of any other information is necessary.

B. System of Governance

B.1. General Information on the System of Governance

B.1.1. Overview

The Board directs, and has responsibility for all activities of the Group. The Directors are drawn principally from the shipowner Members, supplemented by other Directors with specialist knowledge or executive responsibilities.

The Board has outsourced the day to day management of the Group to a third party, Thomas Miller Bermuda Limited or "the Managers".

During the year, the Board of UKB consisted of eight shipowner Directors and two specialist Directors. Following the restructure the Board of UKB was reduced to one shipowner Director and two specialist Directors.

Ultimate parent undertaking post restructure

The Board of UKE, as the ultimate parent undertaking post restructuring has assumed all Group responsibilities, including those listed below. The Board of UKE consists of seven shipowner Directors, two specialist Directors and two Managers.

The Board consider that the System of Governance is appropriate for the nature, scale and complexity of the inherent risks facing the Group.

The Board is supported by several committees.

B.1.1.1. Committee Structure

The Members' Committee ("MEMCO")
MEMCO provides a forum for Members to play an enhanced role in the governance of the Club in relation to mutual Member issues and provides Members' perspective on matters which are relevant to the business of the Club.

Group Audit and Risk Committee ("GARCO")
GARCO is responsible for monitoring the risk management system and internal control framework against the Board's risk appetite. GARCO directs the internal audit function and oversees the external audit function to gain assurance over significant risks.

Strategy Committee ("STRATCO")
STRATCO assists the Board in formulating strategy and providing reports and recommendations on strategic issues and any other issues affecting the Group. The Committee meets on an ad-hoc basis and specifically conducts an annual review of a strategic risk assessment and a review of strategy.

Ship and Membership Quality Committee ("QUALCO")
QUALCO provides the Board with advice regarding the criteria used to establish the suitability of Members. QUALCO also considers whether individual ships or fleets meet the underwriting criteria.

Nominations Committee ("NOMCO")
NOMCO ensure that the Board continues to be composed of suitably qualified and skilled individuals. It also makes recommendations to ensure that the Committees of the Board are composed of individuals appropriate to the respective roles.

Investment Committee (IVCO)
IVCO makes recommendations to the Board in respect of the Investment Mandate and reviews in detail the performance of the investment portfolio.

Material changes
Over the previous 12 months the Group formed the Members' Committee (as described above).

B.1.1.2. Key Functions

The Managers
The Group has no direct employees, except within the Japan Branch, and as such the Board relies on the Managers for day-to-day management duties.

The Investment Managers
Investment of the Group's funds is conducted by the Investment Managers in accordance with the Board's Investment Policies and is subject to internal compliance procedures.

B.1.2. Remuneration

The Group outsources all executive matters to the Managers in accordance with the Management Agreements. The Managers operate a formal performance and merit-based remuneration policy aimed at paying competitive and appropriate remuneration consistent with the long-term interest of the business.

The Group's Remuneration Policy sets out how the Managers are remunerated under a management fee agreement. This is agreed periodically by the Board.

B.1.3. Related party transactions

The Group has no share capital and is controlled by its Members. Throughout the year, all of the Members of UKB are also policyholders of UKE and hence insurance transactions are between related parties, but these are the only transactions between the Group and the Members.

All of the shipowner Directors are representatives of Member companies and have no financial interests in the Group, other than the insurance of their ships entered in the Group, which is arranged on an arm's length basis, and the Member interests of their companies.

B.1.4. Board remuneration

Directors are paid an annual fee and an attendance fee for each meeting. There are no variable components to the Directors' remuneration.

B.2. Fit and Proper Requirements

The Group has in place a Fit and Proper Policy that sets out its approach to the fitness and propriety of the persons responsible for running the Group, including executive senior management and key function holders.

All persons within the scope of the Group's Fit and Proper policy must have the professional qualifications, knowledge and experience and demonstrate the sound judgement necessary to discharge their areas of responsibility competently. They must be of good repute and demonstrate in their personal behaviour and business conduct character, integrity and honesty. As part of the assessment consideration is given to potential conflicts of interest and financial soundness.

The Board members must collectively possess sufficient knowledge, competence and experience to direct and oversee the Group's affairs effectively.

The Managers maintain role specifications for all executive roles that are within the scope of the Fit and Proper policy which detail the key competencies and duties for each position.

Fit and proper assessments are carried out by the Compliance Officer both annually through declarations and formally every three years. No person is permitted to undertake their own assessment.

The Group's Fit and Proper Policy applies to:

- All Directors of Group companies;
- All employees of the Managers who are members of the Thomas Miller's senior management; and
- Persons within the Managers responsible for key functions.

B.3. Risk Management System

The Group's risk management system is the same across all entities within the Group.

The Group's Risk Management System
The Group uses a Risk Management Framework to design an effective risk management system with an integrated approach to risk management and the application of the three lines of defence:

- 1st line of defence: business units and all staff not included in the second and third lines of defence, process and risk owners;
- 2nd line of defence: risk management and compliance functions; and
- 3rd line of defence: internal and external audit.

The risk management system incorporates the accurate and appropriate identification, recording, analysis, reporting and mitigation of risk. The Board has:

- a clearly defined and well-documented risk management strategy;
- adequate written policies;
- appropriate processes and procedures;
- appropriate reporting procedures;
- reports on the material risks faced by the Group and on the effectiveness of the risk management system; and
- a suitable Own Risk and Solvency Assessment ("ORSA").

The risk management system not only covers the risks included in the calculation of the Solvency Capital Requirement but also other risks to which the Group is exposed and which are considered by the Group to be materially relevant to its business. The risk management system is consistently applied to the Group and UKE.

The Partial Internal Model ("PIM")
The internal model is a key risk management tool within the Risk Management Framework. It has been developed by the Actuarial Function in conjunction with the Managers' Risk Committee which fulfils the Risk Management Function of the Group. The underwriting element of the model replaces the underwriting module of the standard formula SCR in the calculation of the Group's SCR. As such, it is referred to as the partial internal model, or PIM. The PIM is subject to additional governance and validation requirements. The Managers' Risk Committee is responsible for determining the scope of the internal model and the PIM.

The internal model is used to analyse the impact of any risk management decisions and changes to the risk profile falling within the scope of the model on the regulatory and internal capital requirements. In particular, the Own Solvency Needs Assessment will be calculated whenever the model is used to determine the capital implications of any changes to the risk profile. The results of these analyses are reported in the ORSA.

All uses of the model are recorded in an internal model uses log, maintained by the Actuarial Function. The Actuarial Function also carried out an annual model

performance review on the PIM, with the results reported to the Managers' Risk Committee and subsequently presented to GARCO and the Board. The review may result in decisions to change the scope of, or otherwise improve, the model.

The use of the PIM is subject to the Internal Model Governance Framework which covers processes and controls applied. Changes to the PIM are subject to the Internal Model Change Policy and validation is carried out in accordance with the Internal Model Validation Policy.

The risk management system also has a coherent focus on data and IT infrastructure governance and appropriate policies and standards to outline the framework within which responsibilities are exercised. It is supported by a robust internal control system and is designed to identify measure, manage, monitor and report significant risks to the achievement of the business objectives.

Risk Management Strategy
The objectives of the Group's risk management strategy are to identify, measure, monitor, manage and report in a consistent, continuous and timely fashion, on the basis of the Group's risk appetite as set by the Board and documented in the Corporate Plan.

The Risk Management Framework helps both support and relay the Group's business plan strategy throughout the organisation by ensuring that those factors that may advance or impede the achievement of strategic and operational objectives are managed by strong controls.

The risks to which the Group is exposed are recorded in the Business Risk Log.

Key Risks
A list of key risks has been compiled by the Board and senior management based on their experience and expert judgement in running the business. This list provides a high-level overview of the principal risks faced by the business which, individually or in combination, may have a significant, substantial or severe impact on the Group.

Implementation of the Risk Management Strategy: Risk Policies and Procedures
The Group's strategy is specified in more detail through its policies and Corporate Plan which underpin its day-to-day business. It sets out the systematic application of management policies, procedures and practices that are used to identify, manage and communicate risk to facilitate Board decision-making and to provide an effective system of risk management.

Policies have been developed for all material risks to which the Group is exposed. They define the Group's approach to risk management overall and more specifically the risk for which the policy has been written. The policies establish the controls, procedures, limits and escalation to ensure that the risks are managed in line with risk appetite. Specific procedures, where appropriate, have been developed to provide full understanding of the means by which the first and second lines of defence will implement the strategy.

The policies also include appropriate reporting procedures to ensure that information relating to the component elements of the risk management is routinely reported to GARCO and to the Board.

Risk Appetite
The Group's risk appetite is articulated in its Risk Appetite Statement, which is a document owned by the Board and reviewed on a regular basis as new risks emerge, or at least annually.

The Board bears ultimate responsibility for the management of risk and for maintaining a sound system of internal control that supports the achievement of the business strategy, policies, aims and objectives of the Group. GARCO supports the Board by providing oversight of the Risk Management Function.

Business Risk Log: Assessment, Measurement and Management
Risks to the business that could inhibit it achieving its business plan objectives are

described in the Business Risk Log, together with the consequences should the risk materialise.

Emerging Risk Log
Risk Owners identify potential emerging risks which are then discussed at the Managers' Risk Committee meeting and included in an emerging risk log which is reviewed annually by GARCO.

Risk Rating
A rating for each risk is determined by assessing its probability and impact of the event if it occurs. The rating assists the Board with the prioritisation and management of risks and demonstrates the importance of the mitigation or controls in place.

The assessment of each risk is on the basis of Inherent Risk and Residual Risk after taking into account the strength of current risk management procedures in place.

All risks on the Business Risk Log are re-assessed on an ongoing basis and at least annually by the Managers and by GARCO and the Board. Each Risk Owner or function head continuously monitors the risks for which they are responsible.

Own Risk and Solvency Assessment ("ORSA")
The ORSA is the process used by the Group to manage its financial and solvency position over the period of its Corporate Plan. The ORSA Overview report is the culmination of this process into a report reviewed by the Board.

The key elements of the ORSA process are:

- An analysis of recent performance;
- Assessment of the risk profile; and
- Consideration of business planning and stress scenarios.

The ORSA overview document is produced twice each year in May and October. GARCO reviews the ORSA and recommends it for approval and use by the Board. The Board reviews and approves the ORSA and considers appropriate actions for the Group such as:

- Capital related decisions;
- General Increase considerations;
- Reassessment of risk profile and risk appetite; and
- Additional risk mitigating actions such as reinsurance.

The Board assesses the adequacy of capital over the business plan time horizon against its risk appetite. To date these assessments indicate that the Group is adequately capitalised.

Risk Controls
The Group's Risk Management Framework has been developed to manage risks across the business, using internal control policies, procedures and processes to control risks.

Whereas ultimate control for each risk rests with the Board, day-to-day control is exercised by the Risk Owners unless otherwise stated, as set out in the Business Risk Log.

The appropriateness and effectiveness of controls is monitored and confirmed by Risk Owners and, for key controls, independently assessed by the Risk Officer.

Risk Mitigation

Reinsurance
One of the key risk mitigation techniques available is reinsurance. The Group considers its whole account reinsurance options leading up to a new policy year. Proposed reinsurance arrangements are analysed by the Actuarial Function, using the internal model, the Managers' Risk Committee and the Reinsurance Committee.

International Group Pool
This can be considered to be a specialised form of reinsurance. The International Group Pool allows for large insurance risks to be shared between its thirteen P&I club members. The International Group also arranges an excess of loss reinsurance programme to cover the largest risks.

Other risk mitigation techniques may be utilised from time to time, for example the use of hedging instruments to mitigate the risk of swings in foreign exchange rates.

Risk Reporting Procedures
Risk Owners are required to provide six-monthly reports on the risks for which they are responsible, based on a template of questions compiled by the Risk Officer. These reports are summarised into key themes and form the basis of an annual Risk Report to GARCO which is then escalated to the Board.

Any amendments to the Business Risk Log proposed by Risk Owners, such as changes to controls or risk descriptions or potential amendments to the ratings are discussed with GARCO for recommendation for approval by the Board.

Risk Owners also identify operational risk loss or near miss events.

Integrated and embedded into the organisational structure and decision-making processes
The Risk Management Function is fulfilled by the Risk Officer and the Managers' Risk Committee. The function maintains an organisation-wide and aggregated view of the risk profile of the Group, including monitoring risk tolerances against appetite, and advising on how risks might impact the business singly and in combination. This analysis includes stress and scenario testing.

The integration of risk management processes with business activities is performed through the requirement for business function heads, who are also risk owners, to focus on risk management on an ongoing basis whilst ensuring that the risks for which they are responsible remain within risk tolerance. This demonstrates the proactive application of risk management techniques to support the business processes and decision-making for which they are also responsible in their day-to-day insurance business activities.

B.4. Internal Control System

Internal control is defined as a continually operating process effected by the Group's Boards, GARCO, the Managers, all staff and systems and designed to support the Group in achieving its business plan objectives through efficient and effective operations and to protect its resources.

Each Risk Owner, as named in the Business Risk Log, is responsible for the application of the Internal Control Framework and the design, development, implementation, documentation and maintenance of effective internal control processes in their area and reporting thereon.

Control activities
Control activities are the actions taken or systems put in place to address business risks, protect assets and ensure that all material control failures and issues are identified and managed. The control activities are embedded into plans, policies, procedures, systems and business processes. Their effectiveness relies on the level of compliance by management and staff.

Control environment
The Managers are responsible for establishing and maintaining an effective control environment throughout the organisation. In furtherance of that, there is a culture which values the highest levels of integrity in the staff, together with openness and honesty in relation to the conduct and reporting of all activities. Policies, procedures and processes are designed to define and support effective, efficient and appropriate activities at every level of the business.

GARCO seeks assurance and provides, through the processes set out in the Compliance policy or through internal audit, assurance to the Board that the scope and quality of compliance monitoring and reporting on regulatory compliance are sufficient to ensure the effectiveness of this Policy and of the management of regulatory compliance risk. All reviews are carried out at least annually and ad hoc as circumstances require.

Internal Audit is authorised to investigate and challenge any actions or concerns without influence from the business; be independent of operational business functions and without undue influence from the Board or other functions/management; have unfettered and direct access to all activities in its area of responsibility, including all documentation, systems, staff, Management, executive and non-executive Board members; and have direct access to the Chairman of GARCO.

Compliance function
The Board bears ultimately responsibility for Regulatory Compliance, and is supported by GARCO.

The Group takes a risk-based approach to regulatory compliance, focussing on preventing breaches to regulatory principles and other rules and informing the relevant regulators of any that are material, or must be reported to regulators on a mandatory basis.

The Compliance Function advises on and promotes compliance with applicable laws, regulatory requirements and administrative provisions and coordinates and monitors implementation of policies, processes and procedures to achieve compliance across the business, and manages regulatory compliance risk.

The impact of Regulatory developments is monitored by the Compliance function. Breaches and associated remedial action are posted to the Operational Risk Database.

B.5. Internal Audit Function

Internal Audit is the (“third line of defence”) in the Group’s internal control framework, established to provide independent assurance that the systems of internal control established by management (“first line”) and the monitoring and oversight provided by the Risk Management and Compliance Functions (“second line”) are fit for purpose and operating effectively.

The objectives of the Internal Audit Function are to provide independent assurance that business risks are identified and are being well managed and controlled by effective systems of internal control.

The Internal Audit function is provided by the Managers who employ an independent Head of Internal Audit (“HIA”) who in turn reports to the Chair of GARCO. The HIA may engage third parties to conduct some audits under his/her management if it is felt that specific technical skills are required or where insufficient general audit resource is available.

Independence
The Internal Audit Function is independent from the organisational activities audited and free to exercise its assignments without impairment and on its own initiative in all areas. It is not authorised to carry out any operational work on behalf of any area of any business. The Head of Internal Audit reports directly to the Chair of GARCO.

B.6. Actuarial Function

The Board is ultimately responsible for ensuring an effective Actuarial Function. This function is performed by the TM Actuarial Team, led by its Chief Actuary.

The Actuarial Function is independent of the Group’s management team and therefore able to undertake its duties in an objective, fair and independent manner.

However, for operational purposes, the Actuarial Function is integrated into the Group's internal control system through its role on the Managers' committees and attendance at Board meetings.

The Actuarial Function makes a significant contribution to the Group's Risk Management Framework by operating its capital model and running the ORSA process and related decisions.

B.7. Outsourcing

The Group outsources all functions, including controlled functions, to the Managers.

The Managers aim to provide a governance framework to facilitate the Group's strategic plan whilst managing risks. The Managers of UKB are Thomas Miller Holdings Ltd Bermuda Board ("TMB Board"). The Managers of UKE are Thomas Miller P&I (Europe) Limited ("TM P&I Europe"). TM P&I Europe operate through several committees, all of which report to the TM P&I Europe Board. These committees include risk, finance, operations, reinsurance, data governance and credit worthiness.

The Group has in place an outsourcing policy which is directed at services or activities which are particularly important or critical to the business ("material business activities").

A material business activity is one that has the potential, if disrupted, to have a significant impact on the business' operations or its ability to manage risks effectively.

Management outsourcing
The Group has no internal executive function and its management is wholly outsourced to the Managers under management agreements.

In order to comply with its regulatory obligations, the Board has developed monitoring and reporting procedures and has delegated to GARCO to monitor internal controls and risk. The risk control and reporting procedures to be followed by the Managers form part of their obligations under the management agreement. GARCO reports to the Board.

Investment management outsourcing
Management of the Group's investments is outsourced to Thomas Miller Investment Limited, part of Thomas Miller, under investment management agreements.

The performance of the investment managers is monitored and supervised by the Board and its Investment Committee.

Internal audit outsourcing
The Group's internal audit function is outsourced to Thomas Miller Internal Audit. Internal Audit is supervised by GARCO and the Board.

Oversight
The Board bears ultimate responsibility for outsourced functions, services, or activities and related governance. The Board are supported by GARCO which reviews outsourcing arrangements and the Manager's Board which monitors the activities of the Group, including outsourcing.

B.8. Any Other Information

The Group considers no other information material to be disclosed.

C. Risk Profile

The key areas of risk impacting the Association can be classified as follows:

1. Underwriting risk – incorporating underwriting and reserving risk;

2. Market risk – incorporating investment risk, interest rate risk and currency rate risk;

3. Credit risk – being the risk that a counterparty is unable to pay amounts in full when due;

4. Liquidity risk – being the risk that cash may not be available to pay obligations as they fall due; and

5. Operational risk – being the risk of failure of internal processes or controls.

The Board has established its appetite for risk in relation to its business strategy and available resources. The Board seeks to maximise their resources by effective risk management techniques. Therefore a risk management system has been developed to identify and mitigate risk.

As part of the risk management system, the Board has developed an internal model to cover underwriting risk. The model is tailored specifically to the underwriting risk accepted by the Group and therefore provides the Board with the expected outcome and risk surrounding business planning scenarios .

This allows the Board to consider more accurately the effectiveness and efficiency of risk mitigation techniques such as reinsurance. The model is designed to encompass the full spectrum of underwriting risks to which the Group is exposed.

C.1. Underwriting Risk

The Group is a mono-line insurer, underwriting only protection and indemnity insurance for the shipping community.

Underwriting risk is the risk that the Group's net insurance obligations (i.e. claims less premiums) are different to expectations. The Group considers the risk of existing obligations (Reserve Risk) separately to the risk of future obligations (Premium Risk).

Reserve risk is managed by the Group's reserving policy. The Group establishes provisions for unpaid claims, both reported and unreported, and related expenses to cover its expected ultimate liability. These provisions are established through the application of actuarial techniques and assumptions. In order to minimise the risk of understating these provisions the assumptions made and actuarial techniques employed are reviewed in detail by management and GARCO.

The Board considers that the liability for insurance claims recognised in the consolidated statement of financial position is adequate. However, actual experience will differ from the expected outcome.

Premium risk is managed by an underwriting policy which establishes robust underwriting practices in order to meet business needs and satisfy regulatory control. This is supplemented with a robust forecasting approach undertaken as part of the ORSA process.

The underwriting process is based on a thorough understanding of the risk accepted. This understanding is enhanced as:

- The Group is a mono-line insurer and has provided broadly the same cover for many years.

- The Board and Members Committee of the Group include representatives from a cross section of the shipping community, giving insight into changes in the risks written over time.

- Underwriting authority is delegated to specific individuals who operate under set underwriting parameters and the ongoing guidance and review of senior management.

Underwriting Risk is mitigated via the Group's reinsurance programme. The programme comprises excess of loss reinsurance cover purchased jointly with other members of the International Group, the International Group Pooling Agreement and reinsurance for claims below the Pool deductible.

The excess of loss reinsurance cover purchased jointly with other members of the International Group provides cover for claims arising from mutual business which exceed $100 million up to a limit of $3.1 billion.

The International Group Pooling agreement provides a sharing of claims costs between thirteen member Clubs. The share attributable to each member is calculated for each policy year on an agreed formula including an adjustment for each Club's historic loss record on the Pool.

In addition to the reinsurance purchased externally, the primary insurer, UKE reinsures 90% of its residual risks to UKB. In addition, part of the International Group Pool is reinsured to a captive reinsurance vehicle, Hydra. The Group has its own segregated cell within Hydra which transacts only with the Group and its subsidiaries. Hydra also accepts a proportion of the risk covered by the joint reinsurance contract for claims above $30 million.

C.2. Market Risk

Market risk within equity investments arises through fluctuations in market valuations.

Market risk in the fixed interest investment valuations arises through changes in interest rates, corporate bond spreads and foreign currency exchange rates. Such movements will affect not only the investments, but also the value of other assets and liabilities such as premium income, claims payments and reinsurance recoveries.

The Group has an investment policy in place to manage exposure to its investments, and this is monitored by regular reports from the investment managers. Further discussion of this arrangement is provided below under the "prudent person principle".

The prudent person principle
Under the Group's investment policy, all of its investments are invested and managed in accordance with the "prudent person principle", meaning that duties of the Investment Managers are discharged with the care, skill, prudence and diligence that a prudent person acting in a like capacity would use in the conduct of an enterprise of like character and aims. More specifically the portfolio:

- is invested in assets and instruments whose risk can properly be identified, measured, monitored, managed, controlled and reported;

- ensures the security, quality and liquidity of the portfolio as a whole;

- is appropriate to the nature, currency and duration of the Group's insurance liabilities;

- includes derivative instruments only where they contribute to a reduction of risks or efficient portfolio management;

- includes only a prudent level of unlisted investments and assets;

- is diversified to avoid excessive reliance on any asset, issuer or group, or geographical area.

The Group's funds are invested by the Investment Managers in accordance with parameters set by an Investment Mandate. The Investment Mandate provides a framework to the Investment Managers for the management and stewardship of the investment assets in conformity with the business and investment objectives and sets the parameters within which the Group's assets may be invested. It is considered and approved by the Board on an annual basis and ad hoc as required and is subject to the Group's Investment Policy. The Investment Managers report to the Board at each meeting.

The following table sets out the Group's exposure to assets by currency as at 20 February 2018 as reported in its IFRS financial statements:

Amounts in $000s	US Dollar	Sterling	Euro	Other	Total
Debt securities	624,846	122,289	80,273	–	827,408
Alternative investments	37,019	–	–	–	37,019
Equities	327,728	44,430	–	–	372,158
Absolute return funds	29	–	–	–	29
UCITS	70,008	800	24	–	70,832
Derivative financial instruments	(25,353)	27,399	739	–	2,785
Cash balances	73,096	3,733	7,892	691	85,412
Amounts due from Members	72,939	220	–	–	73,159
Reinsurers' share of outstanding claims	155,108	–	–	–	155,108
Accrued interest	270	–	–	–	270
Sundry debtors	15,988	–	–	–	15,988
Gross outstanding claims	(751,023)	(106,429)	(94,243)	(34,541)	(986,236)
Other liabilities	0	(14,136)	–	–	(14,136)
	600,655	**78,306**	**(5,315)**	**(33,850)**	**639,796**

C.3. Credit Risk

Credit risk is the risk of loss in the value of financial assets due to counterparties failing to meet all or part of their obligations.

The Group's objective is to reduce credit risk through the risk management techniques discussed below.

The Group is exposed to credit risk from a counterparty failing to comply with their obligations under a contract of reinsurance. In order to manage this risk the Board considers the financial position of significant counterparties on a regular basis, the Reinsurance committee monitors aggregate exposure to each reinsurer and the Group has set selection criteria whereby each reinsurer is required to hold a credit rating greater than or equal to "A" at the time the contract is made.

Amounts due from Members represents premium owing to the Group in respect of insurance business written. The Group manages the risk of Member default through a screening process, to ensure the quality of new entrants, and its ability to cancel cover and outstanding claims to Members that fail to settle amounts payable. The Group limits its reliance on any single Member.

Exposure to bank balances, however, is more concentrated, with two main counterparties and the risk is mitigated by placing funds surplus to normal operational requirements in money market funds and other investments.

The following table shows the Group's assets by counterparty rating as at 20 February 2018 as reported in the Group's IFRS financial statements:

Amounts in $000s	AAA	AA	A	Not readily available/ Not rated	Total
Debt securities	119,285	522,936	–	185,187	827,408
Alternative investments	–	–	–	37,019	37,019
UCITS	70,210	622	–		70,832
Derivative financial instruments	–	–	2,785	–	2,785
Cash balances	–	–	85,412	–	85,412
Amounts due from Members	–	–	–	73,159	73,159
Amounts due from Group pooling arrangement	–	–	52,005	17,671	69,676
Amounts due from reinsurers	–	20,450	64,603	379	85,432
Accrued interest	–	–	270	–	270
Sundry debtors	–	–	–	15,988	15,988
Total of assets subject to credit risk	**189,495**	**544,008**	**205,075**	**329,403**	**1,267,981**
Other Assets					
Equities	–	–	–	372,158	372,158
Absolute return funds	–	–	–	29	29
Total assets	**189,495**	**544,008**	**205,075**	**701,590**	**1,640,168**

C.4. Liquidity Risk

Liquidity risk is the risk that cash may not be available to pay obligations as they fall due. The Group has adopted an investment policy which requires the maintenance of significant holdings in short term deposits to ensure sufficient funds are available to cover anticipated liabilities and unexpected levels of demand. Short term cash needs are monitored to ensure the most efficient investment of cash balances.

The following table outlines the future maturity of assets held by the Group as reported in its IFRS financial statements:

Amounts in $000s	Short term assets	Within 1 year	1-2 years	2-5 years	Over 5 years	Total
Debt securities	–	37,928	27,748	177,659	584,073	827,408
Alternative investments	37,019	–	–	–	–	37,019
Equities	372,158	–	–	–	–	372,158
Absolute return funds	29	–	–	–	–	29
UCITS	70,832	–	–	–	–	70,832
Derivative financial instruments	–	2,785	–	–	–	2,785
Cash balances	85,412	–	–	–	–	85,412
Amounts due from Members	13,471	59,688	–	–	–	73,159
Accrued interest	270	–	–	–	–	270
Sundry debtors	–	15,988				15,988
Reinsurers share of outstanding claims	–	43,797	28,477	42,263	40,571	155,108
Total assets	**579,191**	**160,186**	**56,225**	**219,922**	**624,644**	**1,640,168**

As further disclosed in appendix S.23.01.01, expected loss in future premium is estimated to be $6.5 million. However, it should be noted that this estimated surplus is based upon future cash flows as required by Solvency II and does not therefore necessarily correspond to the estimated surplus under IFRS accounting principles.

C.5. Operational Risk

Operational risk is defined as the risk of direct or indirect loss resulting from inadequate or failed internal processes, people and systems or from external events. In order to mitigate such risks all key processes and controls are documented in a procedural manual. This manual is embedded into the organisation and available to all staff.

Compliance with the procedures and controls documented within the manual is audited on a regular basis through quality control checks and the internal audit function which is directed and reviewed by GARCO. A human resource manual and including all key policies have also been documented.

The Managers are protected against loss through errors and omissions through the purchase of insurance cover. The Group therefore benefits indirectly from this cover.

C.6. Other Material Risks

The Group has not identified any other material risks that it considers necessary for disclosure.

C.7. Any Other Information

Stress and Scenario testing
Stress and scenario tests are presented within the Group's ORSA overview document and are assessed at a Group level. These are based upon the business plan and project the financials over the next four years. The solvency position is considered relative to the Group's risk appetite statement.

The Group's most recent ORSA Overview report includes the following scenarios:

- Drop in the value of GBP to USO
- High claims experience
- Cyber risk

The scenario testing results show that the Group is most vulnerable to high claims experience. However it benefits from significant reinsurance cover and is expected to continue to meet its capital requirements in all scenarios.

D. Valuation for Solvency Purposes

For presentational purposes, Hydra has been deconsolidated and treated as an investment in the IFRS section in all tables that follow in order to facilitate the appropriate comparison between Solvency II and IFRS valuation bases.

In the Group's IFRS financial statements, Hydra is consolidated in the Group result. The treatment outlined above did not have a material impact on the Group's free reserves, however, does affect the classification of amounts. Under Solvency II, Hydra is treated as a third party reinsurer and not consolidated as part of the group as further detailed in A.1.

D.1. Assets

Valuation of the Group's assets as at 20 February 2018:

Amounts in $000s	Solvency II	IFRS
Investments	1,196,568	1,207,084
Reinsurance share of technical provisions	369,334	232,311
Insurance and reinsurance receivables	16,600	85,710
Receivables (trade, not insurance)	3,334	2,424
Cash and cash equivalents	100,115	100,115
Any other assets not elsewhere shown	14,507	14,507
	1,700,458	**1,642,151**

The above table presents amounts using Solvency II and IFRS valuation bases respectively. For classification purposes amounts have been aggregated using Solvency II classification methodologies.

Refer to appendix S.02.01.02 for a full Solvency II balance sheet. The Group's assets are valued using the following principles:

Investments
Investments are carried at market value. Market value is calculated using the bid price at the close of business on the balance sheet date. The market value of foreign currency investments is translated at the rate of exchange ruling at the balance sheet date.

Fair values of investments traded in active markets are measured at bid price. Where there is no active market, fair value is measured by reference to other factors such as independent valuation reports.

A financial instrument is regarded as quoted in an active market if quoted prices are readily and regularly available from an exchange, dealer, broker, industry Group, pricing service or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis. If the above criteria are not met, the market is regarded as being inactive.

Derivatives are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently re-measured at their fair value. All derivatives are carried as assets when the fair value is positive and as liabilities when the fair value is negative.

The fair value of foreign exchange forward contracts is based on current forward exchange rates.

Hydra Insurance Company operates through several segregated cells. One of these cells is controlled by the Group and all transactions of the cell are in respect of its business. Therefore this Hydra cell is consolidated into the results of the Group for the purposes of the IFRS financial statements.

Under Solvency II valuation requirements Hydra is treated as a third party reinsurer. Therefore the Group's interest in Hydra is not consolidated in the Solvency II balance sheet, but treated as an investment using a Solvency II valuation basis.

Reinsurance share of technical provisions
Reinsurance share of technical provisions is valued consistent with gross technical provisions. Refer to D.2. for further details.

Cash and cash equivalents
Cash and cash equivalents include cash at bank or in hand. The carrying value of these balances is considered to be a suitable proxy for fair value.

Insurance and reinsurance receivables
These represent balances that are due for existing insurance and reinsurance contracts. Due to the short term nature of these balances, the carrying amount is considered to be a suitable proxy for its fair value.

When these amounts are not yet due, they are included as a future cash flow in the calculation of technical provisions.

Under statutory accounting requirements, these balances are presented separately on the face of the balance sheet whether they are due or not yet due.

Receivables (trade, not insurance)
This balance includes sundry, short term receivable balances the value and settlement of which contains little to no uncertainty. Due to the short-term nature of these items, the carrying amount is considered to be a suitable proxy for its fair value.

Any other assets not elsewhere shown
These represent all asset balances not included above. These items are all of a short-term nature, and as such their carrying amounts are considered to be a suitable proxy for its fair values. There is no material differences between the valuation used for Solvency purposes and the valuation used in the Group's financial statements.

D.2. Technical Provisions

Amounts in $000s	2018	2017
Gross best estimate	974,580	862,810
Risk Margin	59,973	71,939
Reinsurance best estimate	(369,334)	(328,956)
Net technical provisions	**665,219**	**605,793**

Technical provisions
This relates to the Group's insurance liabilities, which all fall under the "marine, aviation and transport" line of business under Solvency II. As well as claims arising from its own Members, the Group also participates in the International Group of P&I Clubs and so shares claim amounts above a certain level with other participating P&I clubs.

Solvency II requires the technical provisions to be calculated as the sum of a best estimate and a risk margin. The best estimate is valued as the probability-weighted average of future cash flows, taking account of the time value of money, and the risk margin is calculated on a cost-of-capital basis. In addition, for the best estimate, there are three elements to consider: claims, premiums and expenses.

The calculation of the different elements of the technical provisions is discussed below.

Claims
The claims outstanding element of the technical provisions is calculated using standard actuarial techniques to project the cash flows (including chain ladder and Bornhuetter-Ferguson methods). The key assumptions related to the initial expected claims cost for each policy year and the projected notified claims development pattern. These methods are considered appropriate given the longevity and stability of the Group and its claims handling processes.

Allowance is also made for claims on contracts bound, but for which coverage has not yet incepted (corresponding to the premium provision). These cash flows are the most uncertain element of the technical provisions. The uncertainty involved was further discussed in Section C.1 on Underwriting Risk.

Premiums

The premiums element of the best estimate covers (i) the outstanding instalments of premium on expired business that are payable but not yet due on the valuation date (corresponding to the provision for claims outstanding); and (ii) the premium payable but not yet due on bound but not incepted business (corresponding to the premium provision).

Nearly all of the Group's policies are coterminous with its financial year. As such, the renewal is completed and therefore bound before the financial year end. The consequence is that nearly a full year's worth of business is recognised as bound but not incepted business.

Expenses

When calculating the best estimate, a provision is made for all expense cash flows incurred in servicing insurance obligations. This includes both direct and overhead expenses, as well as investment management expenses. The provision is calculated directly in respect of the provision for claims outstanding (for expired business) and a corresponding amount is derived in respect of the premium provision (for bound but not incepted business).

Risk margin

The risk margin is calculated based on the requirement to hold capital to meet the SCR until all claims liabilities are settled and a cost-of-capital rate of 6% per annum. The SCR in this context is made up of Underwriting Risk, Counterparty Default Risk and Operational Risk only; assets are assumed to be invested in such a way that Market Risk will be zero. A detailed analysis has been carried out to determine the run off profile of these risks. The results of this analysis have been used to project the SCRs required in future time periods.

Reinsurance recoverables

This relates to the Group's expected recoverables from its reinsurance arrangements at the valuation date. It is made up of two elements: reinsurance recoveries and reinsurance premiums. These are valued on a consistent basis with the corresponding claims and premiums elements of the technical provisions. In addition, an adjustment is made to take account of expected losses due to default of the reinsurance counterparties.

Differences between IFRS and Solvency II technical provisions

A reconciliation of IFRS technical provisions to Solvency II technical provisions is provided below:

Amounts in $000s	*Note*	Gross	RI	Net
IFRS technical provisions		**986,236**	**232,311**	**753,925**
Adjustments to best estimate valuation basis	1	54,580	140,265	(85,865)
Reallocations	2	(69,181)	(7,548)	(61,633)
Adjustment to expense reserve	3	13,918	–	13,918
Provision for contracts bound but not incepted	4	73,855	61,440	12,416
Reinsurance counterparty default adjustment	5	–	(10,398)	10,398
Effects of discounting	6	(84,828)	(46,736)	(38,092)
Solvency II technical provisions before risk margin		**974,580**	**369,334**	**605,246**
Risk Margin	1	**59,973**	**–**	**59,973**
Total Solvency II technical provisions		**1,034,553**	**369,334**	**665,219**

Notes

1. Adjustments to best estimate valuation basis
Since the Solvency II technical provisions figure is a true best estimate, the IFRS technical provisions are adjusted for the following items:

- All margins for prudence are removed;

- A provision is made for events not in data ("ENID") to represent a true average of future outcomes;

- Technical provisions are stated both gross and net of reinsurance; and

- An additional Solvency II risk margin which is intended to represent a notional market value adjustment.

2. Reallocations
This is based on the elimination of unearned premium and reallocation of various amounts from the IFRS balance sheet to Solvency II technical provisions.

The Solvency II balance sheet contains no concept of deference of premium, and as such any such balances are eliminated upon transition to the Solvency II balance sheet.

Furthermore, under Solvency II valuation methodologies, all future cash flows are included in the calculation of technical provisions. More specifically, any amount not yet due shall be included as a future cash inflow under the calculation of Solvency II technical provisions. As a result, these amounts are reallocated from the accounting balance sheet to technical provisions on the Solvency II balance sheet.

3. Adjustment to expense reserve
Unlike IFRS, Solvency II recognises all expense cash flows incurred in servicing insurance obligations. This includes both direct and overhead expenses, as well as investment management expenses. As such, an adjustment is made.

4. Provision for contracts bound but not incepted
Solvency II valuation methodology requires contracts to be recognised when the insurer becomes party to the insurance contract. Usually, an undertaking becomes a party to the contract when the contract between the undertaking and the policyholder is legally formalised.

Nearly all of the Group's policies are coterminous with its financial year. The consequence is that nearly a full year's worth of business is recognised as Bound But Not Incepted ("BBNI") business. A provision on the Solvency II balance sheet, known as the "premium provision", is thus made for future premiums, claims and expenses that relate to BBNI business.

5. Reinsurance counterparty default adjustment
For the Solvency II balance sheet, amounts recoverable from reinsurance counterparties must be adjusted for the expected losses due to the risk of counterparty defaults. This adjustment approximates the expected present value of the losses in the event of default, weighted by the probability of default for each counterparty. Under current accounting bases a provision for bad debts is only made where there is objective evidence that counterparty may default on its obligation.

6. Effects of discounting
Since Solvency II technical provisions take into account the time value of money, an adjustment is made for the discounting of all future cash flows, based on risk-free interest rates. This includes an adjustment for items previously discounted at rates other than the risk-free rate.

D.3. Other Liabilities

Valuation of the Group's other liabilities as at 20 February 2018:

Amounts in $000s	Solvency II	IFRS
Technical provisions	1,034,553	986,236
Insurance and intermediaries payables	3,266	3,266
Reinsurance payables	250	7,628
Payables (trade not insurance)	5,762	5,762
Subordinated liabilities in Basic Own Funds ("BOF")	99,816	99,816
Any other liabilities not elsewhere shown	421	421
	1,144,068	**1,103,129**

The above table presents amounts using Solvency II and IFRS valuation bases respectively. For classification purposes amounts have been aggregated using Solvency II classification methodologies.

The Group's other liabilities are valued using the following principles:

Technical provisions
The valuation principles of technical provisions are further detailed in D.2.

Reinsurance payables
These represent balances that are due to be paid for existing reinsurance contracts.

When these amounts are not yet due to be paid, they are included as a future cash flow in the calculation of reinsurance technical provisions.

Under statutory accounting requirements, these balances are presented separately on the face of the balance sheet whether they are due or not yet due.

Payables (trade, not insurance)
This balance includes sundry, short-term payable balances the value and settlement of which contains little to no uncertainty. Due to the short-term nature of these items, the carrying amount is considered to be a suitable proxy for its fair value.

Subordinated liabilities in Basic Own Funds ("BOF")
This represents a perpetual subordinated loan which has a principal amount of $100 million and was issued on 20 August 2008. Given that these securities are recognised under transitional arrangements it is treated as tier 1 restricted BOF under Solvency II requirements.

Any other liabilities not elsewhere shown
All other amounts comprise balances not included in liabilities above. Due to its short-term nature, the carrying amount is considered a suitable proxy for its fair value.

D.4. Alternative methods of valuation

The Group does not utilise any alternative methods of valuation.

D.5. Any other information

The Group has not identified any other information that it considers material to be disclosed.

E. Capital Management

E.1 Own funds

Amounts in $000s	2018	2017
SCR ratio	202.05%	169.90%
SCR	343,672	374,968
Eligible capital	694,380	637,054
Excess/(shortfall)	350,708	262,086
MCR Ratio	2124.73%	1500.40%
MCR	30,884	40,385
Eligible capital	656,206	605,934
Excess/(shortfall)	625,322	565,549
Tier 1 Basic own funds	656,206	597,858
Tier 2 ancillary own funds	38,174	39,200

As a mutual insurer with no share capital the Group's capital structure consists of two types of own funds:

1. Accumulated income and expenditure account reserve and reconciliation reserve, which falls under Tier 1 and counts as BOF. These funds may be fully utilised to meet both the SCR and MCR. The Tier 1 basic own funds also includes a perpetual subordinate loan of $100 million. This is recognised as restricted tier 1 under the transitional arrangements.

2. According to its rules, the Group is entitled to make unlimited calls for supplementary premium to be made on Members. When received, they would become Tier 1 loss absorbent BOF and therefore count as Tier 2 Ancillary Own Funds ("AOF") for regulatory solvency purposes.

   The PRA has granted approval to UKE for a method of calculating AOF. The method, which results in AOF of $38.2 million, has been approved for a period of 4 years.

   Under the Solvency II regulations, up to 50% of the SCR may be covered by these funds. This amounted to $38.2 million of tier 2 AOF being eligible towards SCR coverage.

   As far as possible, the Group seeks to provide certainty over the insurance costs borne by Members and therefore would only make a supplementary call in extreme circumstances. These circumstances might include, but are not limited to, being unable to meet its regulatory capital requirements or other internal or external capital measures.

   No items have been deducted from own funds and there are no significant restrictions affecting the availability and transferability of own funds.

   The Group's MCR is $30.8 million.

Information, objectives, policies and processes for managing own funds
The Group's objective under its Corporate Plan is to maintain its total capital resources (own funds) in line with its risk appetite statement over the insurance cycle. The Group forecasts its capital over a 4 year planning horizon as part of its ORSA process.

Material differences between equity as shown in the financial statements and the excess of assets over liabilities
The table below provides a reconciliation of the capital reported within the Financial Statements to that within the Solvency II balance sheet.

Amounts in $000s	2018	2017
Financial Statements	**539,022**	**557,817**
Solvency II gross technical provisions adjustment	(48,317)	(10,207)
Of which reallocations from IFRS balance sheet	(68,201)	(74,488)
Solvency II RI technical provisions adjustment	137,023	115,158
Of which reallocations from IFRS balance sheet	7,378	9,578
Hydra valuation adjustment	(10,516)	–
Total Solvency II basic own funds	**556,389**	**597,858**

The most material adjustment to reserves is as a result of the differences in valuation of technical provisions. Refer to D.1 to D.3 for a discussion of the differences between the bases.

E.2 Solvency Capital Requirement and Minimum Capital Requirement

SCR and MCR

The table below summarises the capital requirements for the current period. Further details can be found in appendices S.25.02.21:

Amounts in $000s	2018	2017
SCR	**343,672**	**374,968**
Made up of		
Operational risk	29,237	25,884
Market risk	219,471	141,259
Underwriting and reserving risk	126,504	257,597
Counterparty default risk	68,344	46,335
Diversification effects	(99,884)	(96,107)
MCR	**30,884**	**40,385**

Last year, the Group SCR was calculated using the standard formula. After obtaining Group and Solo model approval in February 2018, these SCRs have been calculated using the partial internal model to evaluate the Group's Underwriting Risk, while the other risks are evaluated using the standard formula. Consolidation Method 1 has been used to assess the Group balance sheet and SCR.

The SCR has increased from $294.8m to $343.7m, driven by an increase in market risk as a result of (i) receipt of a $110m reinsurance commutation from Swiss Re; and (ii) currency risk increasing in respect of minor currencies as a result of a change in methodology. The Eligible Own Funds have also increased by $59m, driven by the surplus reported over the year.

E.3 Use of the duration-based equity risk sub-module in the calculation of the Solvency Capital Requirement

This sub-module is not used by the Group.

E.4 Differences between the standard formula and any internal model used

The Group has an internal model which it uses for all key decisions as part of its ORSA process. It also has approval from the regulator to use this model to calculate its SCR under Solvency II as described below.

Internal Model Scope
The standard formula is made up of four broad risk categories: underwriting risk (which includes premium risk and reserve risk), counterparty default risk, market risk and operational risk. Most of these risk categories are thought to be broadly appropriate for the Group on the grounds that the Group's exposure to these risks should not be materially different to that of a typical insurer that the standard formula was designed for.

However, as a P&I insurer, the Group's risk profile for underwriting risk is very different to that of typical insurers in the marine, aviation and transport insurance line of business. Consequently, it is inadequately reflected by the standard formula. This is exacerbated by the fact that the standard formula does not adequately reflect the Group's reinsurance structure.

Accordingly, the Group has elected to use a partial internal model to replace the underwriting risk module of the standard formula SCR. All other risk modules within the SCR are calculated according to the standard formula. The improvements to the calculation of underwriting risk module mean that the resulting partial internal model SCR better reflects the Group's risk profile.

Partial Internal Model – Underwriting Risk modelling approach
A high-level summary of the partial internal model and the modelling techniques used are outlined below.

- The Partial Internal Model is a stochastic model built using industry standard software. It is consistent with the risk measures (1-in-200 value at risk) and time period (1 year) adopted by the standard formula.

- Premium Risk – Claims are modelled separately for the key classes of business (Chartered, Owned, Pool and Non-Poolable risks). For each of these classes, claims are modelled by frequency and severity for attritional and large claims separately.

- Reserve Risk – Claims are modelled separately for the Group's key reserving classes (Chartered, Owned (including Non-Poolable), Pool and Occupational Disease). Due to the complexities of these risks and associated reinsurance structures, standard industry methodologies (e.g. chain ladder bootstraps) are not always valid. The Group therefore uses different approaches for modelling each of these risk classes including; an in-house developed individual claims development methodology; modified chain ladder bootstraps; and scenario based approaches.

The nature and appropriateness of the data used in the internal model
The key data sources used in the model are:

- The historical exposure and claims history of the Chartered, Owned and Non-Poolable classes.

- The historical exposure and claims history of the Pool class, which is collected from all members of the International Group and collated within the International Group Data Collection Portal (DCP).

As part of the Group's Solvency II implementation project a significant level of work was undertaken in order to validate and document these data items. Various checks and controls are now carried out as part of business as usual activity, which ensure that the data continues to meet Solvency II standards in relation to completeness, accuracy and appropriateness. In addition to these ongoing controls, the key data elements used for reserving (and the Group's Internal Model) are reviewed against Solvency II standards as part of the annual Actuarial Function Data Opinion.

E.5 Non-compliance with the Minimum Capital Requirement and non-compliance with the Solvency Capital Requirement

The Group has fully complied with the SCR and MCR requirements during the period under review.

Refer to section E.2 for results of the SCR I MCR Calculations.

E.6 Any other information

The Group's owns funds are fully available and transferable and therefore no deductions are required.

The Group does not apply any undertaking specific parameters within the calculation of the SCR.

Appendix: UKE Solo information

The Group has received a waiver from the PRA to present a single Group SFCR that incorporates the result of both the Group and UKE on a solo basis. The main part of this SFCR presents the Group results, unless otherwise stated. The results of UKE on a solo basis are detailed in this appendix.

1. UKE Valuation for Solvency Purposes

1.1 UKE Assets

Valuation of the UKE's assets as at 20 February 2018:

Amounts in $000s	Solvency II	IFRS
Investments	219,608	219,608
Reinsurance share of technical provisions	937,530	910,630
Insurance and reinsurance receivables	15,747	84,857
Receivables (trade, not insurance)	1,215	1,124
Cash and cash equivalents	53,170	53,170
Any other assets not elsewhere shown	103	103
	1,227,373	**1,269,492**

The above table presents amounts at Solvency II and IFRS valuation bases respectively. For classification purposes an aggregated Solvency II classification of amounts has been used in order to best demonstrate any valuation differences between the two bases.

Refer to UKE appendix S.02.01.02 for a full Solvency II balance sheet.

UKE's assets are valued in accordance with the Group's valuation principles further detailed in D.1.

1.2. UKE Technical Provisions

Net technical provisions as at 20 February 2018:

Amounts in $000s	2018	2017
Gross best estimate	974,580	862,810
Risk Margin	22,745	23,624
Reinsurance best estimate	(937,530)	(829,941)
Net technical provisions	**59,795**	**56,493**

Refer to UKE QRTs S.17.01.02 and S.19.01.21 in the appendices for further details on technical provisions.

UKE's technical provisions are valued in accordance with the Group valuation principles further detailed in D.2.

Differences between IFRS and Solvency II technical provisions
A reconciliation of IFRS technical provisions to Solvency II technical provisions is provided below:

Amounts in $000s	*Note*	Gross	RI	Net
IFRS technical provisions		**986,236**	**910,630**	**75,606**
Adjustments to best estimate valuation basis	1	54,579	63,150	(8,571)
Reallocations	2	(69,181)	(60,116)	(9,065)
Adjustment to expense reserve	3	13,918	12,526	1,392
Provision for contracts bound but not incepted	4	73,856	102,963	(29,107)
Reinsurance counterparty default adjustment	5	0	(11,008)	11,008
Effects of discounting	6	(84,828)	(80,615)	(4,213)
Solvency II technical provisions before risk margin		**974,580**	**(937,530)**	**37,050**
Risk Margin	1	**22,745**	**–**	**22,745**
Total Solvency II technical provisions		**997,325**	**(937,530)**	**59,795**

Notes

1. Adjustments to best estimate valuation basis
Since the Solvency II technical provisions figure is a true best estimate, the IFRS technical provisions are adjusted for the following items:

- All margins for prudence are removed
- A provision is made for events not in data ("ENID") to represent a true average of future outcomes
- Technical provisions are stated both gross and net of reinsurance
- An additional Solvency II risk margin which is intended to represent a notional market value adjustment.

2. Reallocations
This is based on the elimination of unearned premium and reallocation of various amounts from the IFRS balance sheet to Solvency II technical provisions.

The Solvency II balance sheet contains no concept of deference of premium, and as such any such balances are eliminated upon transition to the Solvency II balance sheet.

Furthermore, under Solvency II valuation methodologies, all future cash flows are included in the calculation of technical provisions. More specifically, any amount not yet due shall be included as a future cash inflow under the calculation of Solvency II technical provisions. As a result, these amounts are reallocated from the accounting balance sheet to technical provisions on the Solvency II balance sheet.

3. Adjustment to expense reserve
Unlike IFRS, Solvency II recognises all expense cash flows incurred in servicing insurance obligations. This includes both direct and overhead expenses, as well as investment management expenses. As such, an adjustment is made.

4. Provision for contracts bound but not incepted
Solvency II valuation methodology requires contracts to be recognised when the insurer becomes party to the insurance contract. Usually, an undertaking becomes a party of the contract when the contract between undertaking and policyholder is legally formalised.

Nearly all of the UKE's policies are coterminous with its financial year. The consequence is that nearly a full year's worth of business is recognised as Bound But Not Incepted ("BBNI") business. A provision on the Solvency II balance sheet, known as the "premium provision", is thus made for future premiums, claims and expenses that relate to BBNI business.

5. Reinsurance counterparty default adjustment
For the Solvency II balance sheet, amounts recoverable from reinsurance counterparties must be adjusted for the expected losses due to counterparty default. This adjustment approximates the expected present value of the losses in the event of default, weighted by the probability of default for each counterparty. Under current accounting bases a provision for bad debts is only made where there is objective evidence that counterparty may default on its obligation.

6. Effects of discounting
Since Solvency II technical provisions take into account the time value of money, an adjustment is made for the discounting of all future cash flows, based on risk-free interest rates. This includes an adjustment for items previously discounted at rates other than the risk-free rate.

1.3. UKE other liabilities

Valuation of the UKE's other liabilities as at 20 February 2018:

Amounts in $000s	Solvency II	IFRS
Technical provisions	997,325	986,236
Insurance and intermediaries payables	3,206	3,206
Reinsurance payables	250	7,628
Payables, trade not insurance	5,384	5,384
Any other liabilities, not elsewhere shown	16,044	68,913
	1,022,209	**1,071,367**

The above table presents amounts using Solvency II and IFRS valuation bases respectively. For classification purposes amounts have been aggregated using Solvency II classification methodologies.

UKE's other liabilities are valued in accordance with the Group's valuation principles further detailed in D.3.

2. UKE Capital Management

2.1. UKE Own Funds

Amounts in $000s	2018	2017
SCR ratio	198.52%	188.71%
SCR	122,577	118,407
Eligible capital	243,339	223,441
Excess/(shortfall)	120,762	105,034
MCR Ratio	669.52%	622.40%
MCR	30,644	29,602
Eligible capital	205,165	184,241
Excess/(shortfall)	174,521	154,639
Tier 1 Basic own funds	205,165	184,241
Tier 2 ancillary own funds	38,174	39,200

UKE's principles for capital management are in accordance with the Group's capital management principles further detailed in section E.

The PRA has granted an approval for a method of calculation of ancillary own funds ("AOF") to UKE. The method, which results in AOFs of $38.2 million has been approved for a period of 4 years.

Under the Solvency II regulations, up to 50% of the SCR may be covered by these funds. This amounted to $38.5 million of tier 2 ancillary own funds being eligible towards SCR coverage.

Material differences between equity as shown in the financial statements and the excess of assets over liabilities
The table below provides a reconciliation of the capital reported within the Financial Statements to that within the Solvency II balance sheet.

Amounts in $000s	2018	2017
Financial Statements	**198,126**	**173,041**
Solvency II gross technical provisions adjustment	(11,089)	38,067
Of which reallocations from IFRS balance sheet	(69,019)	(75,434)
Solvency II RI technical provisions adjustment	26,900	(18,800)
Of which reallocations from IFRS balance sheet	60,247	67,367
Total Solvency II basic own funds	**205,165**	**184,241**

The most material adjustment to reserves is as a result of the differences in valuation of technical provisions. Refer to 1.1 to 1.3 for a discussion of the differences between the bases.

2.2. UKE Solvency Capital Requirement and Minimum Capital Requirement

SCR and MCR
The table below summarises the capital requirements for the current period. Further details can be found in UKE appendices S.25.02.21 and S.28.01.01.

Amounts in $000s	**2018**	**2017**
SCR	**122,577**	**118,407**
Made up of		
Operational risk	28,287	25,884
Market risk	25,442	20,996
Underwriting and reserving risk	11,678	12,329
Counterparty default risk	77,841	77,853
Diversification effects	(20,670)	(18,655)
MCR	**30,644**	**29,602**

The SCR has been calculated using partial internal model and the standard formula as described in section E.4.

The SCR has increased slightly from $118.4m to $122.6m, an increase of $4.2m over the year. This is driven by increases in market risk and operational risk. UKE eligible own funds have also increased as a result of the reported surplus over the year, resulting in an increase in solvency ratio from 189% to 199%.

The inputs into the MCR are net premium ($77.0 million) and net technical provisions ($37.0 million) as further detailed in UKE appendix S.28.01.01.

ukpandi.com