HSB Engineering Insurance Limited
Annual financial statements for the year ended 31 December 2018

Registered number: 2396114

Contents

Company information

Company Number
2396114

Directors
G Barats
J Herdman (Independent Non-executive Chairman)
S Morris
A O'Reilly
J O'Shaughnessy
P Richter
C Scarr
S Worrall

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K Close-Smith

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New London House
6 London Street
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Auditor
KPMG LLP
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Strategic report

The Directors present to the members of HSB Engineering Insurance Limited (the 'Company') the Strategic report for the year ended 31 December 2018. The results for the year for the Company are set out in the financial statements on pages 17 to 46.

A non-financial information statement is not presented in this report as the Company has taken advantage of the exemption available under section 4(7) of The Companies, Partnerships and Groups (Accounts and Non-Financial Reporting) Regulations 2016.

Principal activities

The Company is an insurance company underwriting engineering lines risks primarily located in the United Kingdom and Europe through its UK operation and Republic of Ireland branch. The products and services on offer are underpinned by a high level of engineering and claims management expertise.

The Company has a wholly owned subsidiary undertaking, The Boiler Inspection and Insurance Company of Canada, which underwrites engineering risks in North America, and a wholly owned non-insurance subsidiary company in the UK, HSB Engineering Insurance Services Limited, which provides inspections and consultancy services on plant and equipment.

The Company is a wholly owned indirect subsidiary of Munchener Ruckversicherungs-Gesellschaft Aktiengellschaft (Munich Re).

Basis of preparation of the financial statements

In previous years, the Company's financial statements were prepared on a consolidated group basis, including the results of the Company's two subsidiary undertakings. For 2018, the Company's financial statements have been prepared for the Company only, as permitted by the Companies Act 2006 since the results of the Company and its subsidiaries are included in the publicly-available group financial statements of Munich Re.

Business review and outlook

The results of the Company for the year, as set out on pages 17 and 18, show profit before tax of £3,899,000 (2017: £15,489,000). As at 31 December 2018, the total net assets of the Company were £98,991,000 (2017: £118,729,000).

The Company's total gross written premiums for the year were £49,529,000, which represented a decrease of 7% on 2017. During 2016 the Company made a strategic decision to cease writing new Australian business and commenced lapsing the in-force book in Australia as policies fell due for renewal. Consequently, no new business has been written in Australia since April 2017. Revenue was also reduced in 2018 following the strategic de-selection of larger energy risks in the UK and overseas, as part of the Company's strategy to improve the risk profile of its in-force business and therefore improve future profitability. The reduction in gross written premiums was partly off-set by growth through in product line innovations, most notably machinery inherent defects insurance, computer and cyber insurance.

The Company reported a total net loss ratio for the year of 45% (2017: 36%) and a combined operating ratio of 107% (2017: 93%). These ratios were adversely impacted by reserves established during the year following a fire loss on a project risk within the construction book. The financial and solvency impact was, however, significantly reduced due to the external reinsurance protection arrangements that management have in place to manage the exposure from significant loss events. This loss was considered an outlier event and has had no adverse impact on the Company's future expected loss ratios.

Total interest income for the year was £3,668,000 (2017: £3,669,000), which represented a 3.6% return on the value of investments held at 31 December 2018 (2017: 3.0%). The Company's investment custodian is BlackRock Incorporated and its investment manager is Munich Ergo Asset Manager of New York (MEAG-NY).

The Company has adopted the standard formula for the calculation of its Solvency II capital requirements. The solvency coverage as at 31 December 2018 was substantially above the Company's Solvency Capital Requirement and is forecast to remain strong over the business planning horizon..

Strategic report *(continued)*

Results and dividends
The profit for the year before taxation was £3,899,000 (2017: £15,489,000).

During the year, the Directors declared and paid a dividend of £22,016,000 (2017: £nil). The Directors do not recommend the proposal of any further dividend in respect of the year ended 31 December 2018 (2017: £nil).

Key performance indicators ('KPIs')
The Board of Directors (the Board) monitors the financial performance of the Company by reference to the following KPIs:

	2018	2017	
	£'000	£'000	
Gross written premiums	**49,529**	52,993	
Net written premiums	**46,691**	49,278	Gross written premium less outward reinsurance in respect of insurance contracts.
Net loss ratio	**45%**	36%	Ratio of net claims incurred to net premiums earned.
Combined operating ratio	**107%**	93%	Ratio of net claims incurred, commissions and expenses to net premiums earned.
Solvency capital cover	**227%**	277%	Capital cover as calculated under Solvency II standard formula.

Future developments
The Company will continue to place an emphasis on the long term strategy of growing transactional engineering lines market share and expanding its portfolio of 'white label' insurance products with strategic partners, through organic growth of UK and Ireland transactional business, further development and innovation within its core product lines, including cyber and machinery inherent defects insurance, as well as developing new channels to distribute core products.

The Company has considered the risks posed by the UK's exit from the European Union ("Brexit"). The Company's most significant operation in the EU is in the Republic of Ireland (ROI) where, prior to Brexit, the Company was operating on a freedom of establishment basis. In 2018, the Company's gross written premium in ROI was EUR 2,600,000. In the event of a hard Brexit and in order to continue to trade and support customers in the ROI, the Company has applied to establish a third country branch operation in ROI, under the authorisation of the Central Bank of Ireland. For EU business outside of the ROI the Company has made appropriate plans to ensure minimal disruption to customers in the event of a hard Brexit.

Risk management
The Company adopts a transparent and consistent approach in the design of its risk management framework, applying the Risk Management Principles set out by the Company's immediate and ultimate parent companies. The Company considers risks proportionately, ensuring ownership and accountability throughout the organisation, having several levels of independent oversight in place. The risk framework also ensures staff are well trained and risk management practices and principles are embedded across the organisation.

The Board is collectively responsible for setting the strategic direction of the Company and defining the overall tolerance for risk, including the review of major risk exposures and the establishment of risk limits in material areas. The Board is ultimately also responsible for risk governance, ensuring the Company operates within an established and effective risk framework of internal control systems, policies and procedures that are also compliant with applicable laws and regulations.

The Executive Committee of the Board supports the delivery of the Company's strategy through overseeing the development and delivery of the Company's business plans and financial plans; overseeing the development and implementation of policies and procedures; and identifying and assessing emerging risks and issues along with overseeing associated actions.

Prior to 31 December 2018, the Company had a combined Finance, Audit, Compliance and Risk (F&A) Committee. In addition to the required responsibilities of an audit committee, the F&A Committee was also responsible for overseeing that management have in place an appropriately designed and effective internal control framework so as to manage underwriting, financial, operational, reputational and strategic risks. Subsequent to the year end, this Committee has been separated into an Audit Committee and a Risk Committee, subject to regulatory approval of the proposed chair of the respective Committees.

Risk management *(continued)*

The Audit Committee will be responsible for overseeing that management have in place an appropriately designed and effective internal control framework to manage financial reporting and audit risks.

The Risk Committee will be responsible for overseeing the appropriateness and effectiveness of the Company's strategies, processes and internal controls pertaining to compliance and risk management.

The Company's day to day risk governance is managed by executive sub-committees of the Risk Committee, being the Compliance and Risk Group and Underwriting and Claims Group. The Compliance and Risk Group is comprised of function heads from across the business and is responsible for supervising the day to day compliance advice, monitoring and oversight activities as delegated by the Risk Committee, within the risk appetite and tolerances set by the Board. The Underwriting and Claims Group is a working group which is focused on the specific risks facing underwriting and claims.

A Remuneration and Nominations Committee will be established during 2019, subject to regulatory approval of the proposed chair. This Committee will be responsible for advising the Board on matters relating to Board's membership, Committee memberships and related appointments and for oversight and implementation of the Company's remuneration policy. Previously the Board was responsible for these.

The Pensions Governance Committee is responsible for overseeing the Company's defined contribution pension scheme.

The Charity Committee is responsible for overseeing the Company's charitable donations.

Independent Risk and Compliance functions are in place to provide challenge to the business stakeholders on the effectiveness of the risk management practices being followed, on the risks identified, the strength of the controls in place and any actions being progressed. These functions also provide advice and guidance on the impact of regulatory changes.

The Internal Audit function, which is outsourced to the Company's parent, The Hartford Steam Boiler Inspection and Insurance Company, also undertakes regular risk-based audits to independently assess the quality of business processes and controls, reporting the results of its findings to the management team of the Company and to the Audit Committee.

Principal risks and uncertainties
The major categories of risk exposure for the Company are summarised below.

Underwriting risk
The Company has identified that the principal risks from its general insurance business would most likely arise from inaccurate pricing; fluctuations in the timing, frequency and severity of claims compared to expectations; inadequate reinsurance protection; and inadequate reserving. These risks are managed through underwriting and reinsurance strategies that emphasise appropriate profitability, which are set by Management under supervision by the Board and are communicated throughout the business via policy statements and internal guidelines. For information on exposure to underwriting risk refer to note 3 of the financial statements.

Financial risks
The Company's activities are exposed to financial risk through its financial assets, financial liabilities, reinsurance assets and policyholder liabilities. In particular, a key financial risk is that the proceeds from financial assets are not sufficient to fund the obligations arising from policies as they fall due. The most important components of this financial risk are market risk, credit risk and liquidity risk.

Market risk
Market risk is defined as the risk of economic losses resulting from price changes on the money and capital markets. The Company's main exposure to market risk arises principally from currency risk, interest rate risk and spread risk.

Currency risk
The Company operates internationally and is exposed to currency risk in respect of liabilities under policies of insurance and reinsurance denominated in currencies other than the British pound. Foreign exchange risk arises from future commercial transactions, recognised assets and liabilities and net investments in foreign operations. The most significant currencies to which the Company is exposed are the Euro, the United States Dollar and the Australian dollar.

Strategic report *(continued)*

Principal risks and uncertainties *(continued)*

The Company sets risk tolerance limits for foreign currency exposure and seeks to manage currency risk as part of the liability-driven investment approach by matching, wherever possible, the estimated foreign currency denominated liabilities with assets denominated in the same currency that also have a similar maturity profile to the liabilities they are seeking to match. The Company does not use derivatives to manage its currency (or other) risks. For information on exposure to currency risk refer to note 4 of the financial statements.

Interest rate risk
The Company has exposure to interest rate risk through the variability of the interest income receivable on its financial investment portfolio and the valuation of that fixed rate investment portfolio. The Company seeks to manage this risk as part of its liability-driven investment approach. In addition, to the extent that claims inflation is correlated to interest rates, liabilities are also potentially exposed to interest rate risk. The Company has no significant interest-bearing financial liabilities. For information on exposure to interest rate risk refer to note 4 of the financial statements.

Spread risk
Spread risk arises from the sensitivity in the values of assets, liabilities and financial instruments to changes in the level or volatility of credit spreads over the risk-free interest rate term structure. The Company is exposed to this risk through its investment portfolio, which includes corporate bonds. Spread risk is managed by the Company through setting limits on the proportion of the investment portfolio subject to spread risk and through setting minimum credit quality for invested assets.

Credit risk
Credit risk is defined as the risk of financial loss as a result of a change in the financial position of a counterparty. The Company is exposed to credit risk from risk-mitigating contracts such as reinsurance, cash and cash equivalents and deposits with banks and financial institutions. The Company is also exposed to credit risk on receivables from intermediaries and policyholders.

The Company monitors its exposure to all counterparties and takes corrective action if required to ensure all sums are collected on a timely basis. Maximum counterparty limits and minimum credit ratings are in place for all issuers of investments held by the Company. For information on exposure to credit risk refer to note 4 of the financial statements.

Reinsurance is used to manage insurance risk. This does not, however, discharge the liability of the Company as a primary insurer. If a reinsurer fails to pay a claim, the primary insurer remains liable for the payment to the policyholder. The creditworthiness of reinsurers is considered on an annual basis by reviewing their financial strength prior to finalisation of any contract. In addition, the recent payment history of reinsurers is used to update the reinsurance purchasing strategy.

Liquidity risk
Liquidity risk is defined as the risk that funds are not available to meet obligations at a reasonable time or at a reasonable cost. This risk is managed through cash management activities to ensure the Company maintains sufficient cash and through control of the marketable investment portfolio to ensure funds are available to meet obligations. For information on exposure to liquidity risk refer to note 4 of the financial statements.

Operational risk
Operational risk is defined as the potential losses resulting from inadequate processes, technical failure, human error or external events. The Company adopts a range of measures to mitigate operational risk exposure. Emphasis is placed on the selection and training of managers and staff and the provision of effective guidance, through such measures as documented policies and procedures, operating manuals and system controls. In addition, the Company undertakes regular compliance certification of processes and controls, maintains business continuity plans and undertakes regular operational event reporting and monitoring.

The Internal Control System reporting application is used to document and formally assess operational risks and controls. This system is used to focus attention on any identified weaknesses and action plans are put in place when any weakness is identified. This is used as a basis for review and challenge by Management, the Compliance and Risk Group, the Audit Committee, the Risk Committee and the Board.

The Company's operational risk management framework includes the management of taxation risk. The Company is committed to acting in a prudent and responsible manner and to be an open, transparent and dependable taxpayer. The Company's tax strategy is published on its website.

Strategic report *(continued)*

Principal risks and uncertainties *(continued)*

Reputational risk
Reputational risk is defined as the risk that adverse publicity regarding the Company's business practices and associations, whether accurate or not, will cause a loss of confidence in the integrity of the Company. Reputational risk is controlled within the framework of the Internal Control System and by setting high ethical standards in the employee code of conduct. Reputational risks may result from the realisation of other risks, for example strategic risk or group risk, therefore reputational risks are controlled indirectly through the control of the respective risks and risk types.

Strategic risk
Strategic risk is defined as the risk of making wrong business decisions, implementing decisions poorly, or being unable to adapt to changes in the Company's operating environment. The Company counters strategic risks by closely interlinking strategic decision-making processes with risk management. This process gives consideration to the Company's Own Risk and Solvency Assessment to manage the capital requirements and to ensure the Company has the financial strength and capital adequacy to support the objectives of the business over the long term.

Group risk
Group risk is defined as the risk of any activity, circumstance, event or series of events involving one or more affiliates of the Company that, if not remedied promptly, is likely to have a material adverse effect upon the financial condition or liquidity of the Company.

Outsourcing risk
The Company is reliant on outsourced arrangements for the provision of certain services, which are performed by third parties or other entities within the Group, in particular investment management activities performed by MEAG-NY, reinsurance provided by Munich Re Group entities and IT application and infrastructure support activities, all of which are 'material outsourcing' arrangements as defined under the Solvency II directive. Where services are outsourced, management apply the same risk management and monitoring framework as though the services were provided in-house. With all material outsourcing arrangements there a regular flow of information between the Company and the outsourced service providers in order to mitigate and manage the associated risks.

Regulatory and legal risks
The legal and regulatory environment is subject to continuous change in many of the jurisdictions in which the Company operates, including developments in response to changes in the economic and political environment. The Company continues to monitor the developments and respond accordingly. The Company's Legal and Compliance functions and Risk functions and, where appropriate, external advisors support management and the Board in identifying and implementing necessary steps to ensure the Company remains compliant with applicable regulatory and legislative requirements. The Company is required to comply with the Solvency II reporting regime and to maintain its own funds at a level which meets the Solvency Capital Requirement (SCR). Compliance is reviewed on a quarterly basis by the Risk Committee.

On behalf of the Board

S Worrall

S Worrall
Managing Director
9 April 2019

Registered Number: 2396114

Directors' report

The Directors present to the members of HSB Engineering Insurance Limited their Directors' report and the audited financial statements of the Company for the year ended 31 December 2018.

As permitted by section 414C (11) of the Companies Act 2006, certain information is not included in the Directors' report because it has instead been shown in the Strategic Report. This information is:

- Principal activities of the Company
- Business review and outlook
- Results and dividends
- Principal risks and uncertainties

Political contributions
There were no political contributions made by the Company (2017: none).

Policy and practice on payment to creditors
It is the policy of the Company to settle the terms of payment with all suppliers when agreeing the terms of each transaction when orders for goods and services are placed and to pay in accordance with those terms, ensuring persons are aware of the terms and abide by them.

Directors
The Directors who held office during the year and upto the date of approval of this Directors' Report were as follows:

G Barats
J Herdman
S Leathes (resigned 17 April 2018)
D Mercier (resigned 22 February 2018)
S Morris
A O'Reilly
J O'Shaughnessy (appointed 29 May 2018)
P Richter
C Scarr
S Worrall
S Watkins (resigned 14 December 2018)

Directors' qualifying third party and pension indemnity provisions
The Company, through its ultimate parent company, Munich Re, purchased and maintained liability insurance for its Directors and Officers as permitted by section 233 of the Companies Act 2006.

Tangible fixed assets
Tangible fixed assets are detailed in Note 17 to the accounts. All leasehold property is occupied by the Company for its own use.

Going concern
The Company's business activities, together with the factors likely to affect its future development, performance and position, are set out in the Strategic Report. The Statement of Financial Position shows net assets for the Company as at 31 December 2018 of £98,991,000.

Based upon their own analysis of the available information, including forward looking information, the Directors have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future. Thus they continue to adopt the going concern basis of accounting in preparing the annual financial statements. The Company's capital position on the Solvency II basis is substantially above the Solvency Capital Requirement and is expected to remain strong.

Directors' report *(continued)*

Employees
Disabled persons
Applications for employment by disabled persons are always fully considered, bearing in mind the respective aptitudes and abilities of the applicant concerned. In the event of members of staff becoming disabled every effort is made to ensure that their employment with the Company continues and appropriate training is arranged or support put in place. It is the policy of the Company that the training, career development and promotion of a disabled person should as far as possible, be identical to that of a person who does not suffer from a disability.

Employee involvement
Involvement of employees is achieved through various methods which include, but are not limited to, quarterly all employee meetings, employee forums, periodic employee surveys, performance reviews, Company news bulletins, intranet communications, and staff wellness and recognition programmes. Consultation with employees or their representatives has continued at all levels during the year, with the aim that views are taken into account when decisions are made that are likely to affect their interests.

Diversity
The Company believes that having a diverse employee base is key to the success of the business and our customer experience. The Company is committed to creating an inclusive culture and environment of equality where all employees can have the opportunity to realise their full potential. Gender pay gap information is available on the Company's website. The Directors are committed to continuing to undertake action to address the gender pay gap as well as to promoting the overall diversity of the Company's employee base.

The Company also believes in the importance of maintaining and developing the diversity of its Board, without compromising on the calibre of new directors appointed. Appointments to the Board are based on merit while complementing the existing diversity of skills, knowledge and experience of the Board as a whole.

Disclosure of information to the auditor
The Directors who held office at the date of approval of the Strategic Report and Directors' Report confirm, so far as each Director is aware, there is no relevant audit information of which the Company's auditor is unaware. Each Director has taken all the steps that they ought to have taken as a Director in order to make themselves aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

Auditor
The Company's auditor is KPMG LLP. The auditor is deemed to have been reappointed in accordance with section 487 of the Companies Act 2006 and KPMG LLP will therefore continue in office.

On behalf of the Board

S Worrall
Managing Director
9 April 2019

Registered Number: 2396114

Statement of Directors' responsibilities

The directors are responsible for preparing the Strategic Report, the Directors' Report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law they have elected to prepare the financial statements in accordance with International Financial Reporting Standards as adopted by the European Union (IFRSs as adopted by the EU) and applicable law.

Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of its profit or loss for that period. In preparing the financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable, relevant and reliable;
- state whether they have been prepared in accordance with IFRSs as adopted by the EU;
- assess the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and
- use the going concern basis of accounting unless they either intend to liquidate the Company or to cease operations, or have no realistic alternative but to do so.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that its financial statements comply with the Companies Act 2006. They are responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error, and have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Company and to prevent and detect fraud and other irregularities.

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the company's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Independent Auditor's Report to the members of HSB Engineering Insurance Limited

1 Our opinion is unmodified

We have audited the financial statements of HSB Engineering Insurance Limited ("the Company") for the year ended 31 December 2018 which comprise the Income statement, Statement of other comprehensive income, Statement of financial position, Statement of changes in equity, Statement of cash flows, and the related notes, including the accounting policies in note 1.

In our opinion the financial statements:

- give a true and fair view of the state of Company's affairs as at 31 December 2018 and of its profit for the year then ended;
- have been properly prepared in accordance with International Financial Reporting Standards as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities are described below. We believe that the audit evidence we have obtained is a sufficient and appropriate basis for our opinion. Our audit opinion is consistent with our report to the audit committee.

We were first appointed as auditor by the directors on 21 October 2009. The period of total uninterrupted engagement is for the ten financial years ended 31 December 2018. We have fulfilled our ethical responsibilities under, and we remain independent of the Company in accordance with, UK ethical requirements including the FRC Ethical Standard as applied to public interest entities. No non-audit services prohibited by that standard were provided.

2 Key audit matters: including our assessment of risks of material misstatement

Key audit matters are those matters that, in our professional judgment, were of most significance in the audit of the financial statements and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by us, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. We summarise below the key audit matters in arriving at our audit opinion above, together with our key audit procedures to address those matters and, as required for public interest entities, our results from those procedures. These matters were addressed, and our results are based on procedures undertaken, in the context of, and solely for the purpose of, our audit of the financial statements as a whole, and in forming our opinion thereon, and consequently are incidental to that opinion, and we do not provide a separate opinion on these matters.

The impact of uncertainties due to the UK exiting the European Union on our audit **New event driven risk** *Refer to page 5 (Strategic report)*	
The risk	**Our response**
Unprecedented levels of uncertainty: All audits assess and challenge the reasonableness of estimates, in particular as described in valuation of claims outstanding below, and related disclosures. All of these depend on assessments of the future economic environment and the Company's future prospects and performance. In addition, we are required to consider the other information presented in the Strategic report including the principal risks disclosure and to consider the directors' statement that the Strategic Report, Directors' Report and financial statements taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the Company's position and performance, business model and strategy.	We developed a standardised firm-wide approach to the consideration of the uncertainties arising from Brexit in planning and performing our audits. Our procedures included: • **Our Brexit knowledge**: We considered the directors' assessment of Brexit-related sources of risk for the Company's business and financial resources compared with our own understanding of the risks. We considered the directors' plans to take action to mitigate the risks. • **Assessing transparency**: As well as assessing individual disclosures as part of our procedures on valuation of claims outstanding, we considered all of the Brexit related disclosures together, including those in the Strategic report, comparing the overall picture against our understanding of the risks.

Brexit is one of the most significant economic events for the UK and at the date of this report its effects are subject to unprecedented levels of uncertainty of outcomes, with the full range of possible effects unknown.	**Our results** • As reported under valuation of claims outstanding, we found the resulting estimates and related disclosures of sensitivity to be acceptable. However, no audit should be expected to predict the unknowable factors or all possible future implications for a company and this is particularly the case in relation to Brexit.

Valuation of claims outstanding (£59.7 million; 2017: £43.8 million) **Recurring risk ◄►** *Refer to page 25 (accounting policy) and pages 29-31 and 41-43 (financial disclosures).*	
The risk	**Our response**
Subjective Valuation: The Company maintains a provision for claims outstanding to cover the estimated cost of settling all existing and expected future claims with respect to insured risks, whether or not those losses have been reported to the Company as at the balance sheet date. The valuation of claims outstanding requires significant judgement including the use of actuarial expertise. Calculation of claims outstanding uses historical data, which is sensitive to both internal and external inputs including claims handling costs, claims cost inflation and operational changes affecting the development profile of both past and incurred claims. It also requires assumptions such as initial expected loss ratio ("IELR") and pattern of loss emergence to be made in respect of whether, and to what extent, past experience can be used to estimate future outcomes. Small changes in the assumptions and estimates used to value the claims outstanding can have a significant impact on the overall valuation of claims outstanding. The effect of these matters is that, as part of our risk assessment, we determined that the valuation of claim outstanding has a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality for the financial statements as a whole, and possibly many times that amount. The financial statements (note 3) disclose the sensitivity estimated by the Company.	Our procedures included: • **Our actuarial expertise:** using our own actuarial specialists, inspecting the claims reserving reports and evaluating and challenging the assumptions derived by the Company from past experience. This is done by critically assessing the Company's methodology for valuing claims outstanding, comparing the assumptions used in the valuation of claims outstanding to expectations based on the Company's historical experience, current trends and our own industry knowledge. • **Independent re-performance:** for all classes of business, calculating our own alternative estimate of the claims outstanding using the Company's data, comparing to the liability calculated by the Company, and considering the impact of any significant differences. • **Benchmarking assumptions:** We evaluated the prudence margin by benchmarking to market data as well as industry best practice methodology. • **Actual versus expected testing:** Challenged the quality of the Company's historical valuation of claims outstanding by monitoring progression of loss ratios against expectations. • **Assessing transparency:** assessing the Company's disclosures relating to the valuation of claims outstanding, in particular in relation to the sensitivity of key assumptions. **Our results** • We found the valuation of the claims outstanding to be acceptable (2017 result: acceptable).

3 Our application of materiality and an overview of the scope of our audit

Materiality for the financial statements as a whole was set at £0.5m (2017: £0.5m), determined with reference to a benchmark of gross written premium, of which it represents 1.0% (2017: 0.9%). We consider gross written premiums to be the most appropriate benchmark as it provides a more stable measure year on year than profit before tax. We agreed to report to the Audit Committee any corrected or uncorrected identified misstatements exceeding £0.03m (2017: £0.03m) in addition to other identified misstatements that warranted reporting on qualitative grounds. Our audit of the Company was undertaken to the materiality level specified above and was all performed at the Company's office in Manchester.

Independent Auditor's Report *(continued)*

4 We have nothing to report on going concern

The Directors have prepared the financial statements on the going concern basis as they do not intend to liquidate the Company or to cease its operations, and have concluded that the Company's financial position means that this is realistic. They have also concluded that there are no material uncertainties that could have cast significant doubt over its ability to continue as a going concern for at least a year from the date of approval of the financial statements ("the going concern period").

Our responsibility is to conclude on the appropriateness of the Directors' conclusions and, had there been a material uncertainty related to going concern, to make reference to that in this audit report. However, as we cannot predict all future events or conditions and as subsequent events may result in outcomes that are inconsistent with judgements that were reasonable at the time they were made, the absence of reference to a material uncertainty in this auditor's report is not a guarantee that the Company will continue in operation.

In our evaluation of the Directors' conclusions, we considered the inherent risks to the Company's business model, and analysed how those risks might affect the Company's financial resources or ability to continue operations over the going concern period. The risks that we considered most likely to adversely affect the Company's available financial resources over this period were:

- significant adverse deviation in insurance claims experience; and
- a deterioration in the valuation of the Company's investments arising from a significant change in the economic environment.

As these were risks that could potentially cast significant doubt on the Company's ability to continue as a going concern, we considered sensitivities over the level of available financial resources indicated by the Company's financial forecasts taking account of reasonably possible (but not unrealistic) adverse effects that could arise from these risks individually and collectively and evaluated the achievability of the actions the Directors consider they would take to improve the position should the risks materialise. We also considered less predictable but realistic second order impacts, such as the impact of Brexit.

Based on this work, we are required to report to you if we have anything material to add or draw attention to in relation to the directors' statement in Note 1 to the financial statements on the use of the going concern basis of accounting with no material uncertainties that may cast significant doubt over the Company's use of that basis for a period of at least twelve months from the date of approval of the financial statements.

We have nothing to report in these respects, and we did not identify going concern as a key audit matter.

5 We have nothing to report on the Strategic Report and the Directors' Report

The directors are responsible for the strategic report and the directors' report. Our opinion on the financial statements does not cover those reports and we do not express an audit opinion thereon.

Our responsibility is to read the strategic report and the directors' report and, in doing so, consider whether, based on our financial statements audit work, the information therein is materially misstated or inconsistent with the financial statements or our audit knowledge. Based solely on that work:

- we have not identified material misstatements in those reports;
- in our opinion the information given in the strategic report and the directors' report for the financial year is consistent with the financial statements; and

in our opinion those reports have been prepared in accordance with the Companies Act 2006.

6 We have nothing to report on the other matters on which we are required to report by exception

Under the Companies Act 2006, we are required to report to you if, in our opinion:

- adequate accounting records have not been kept by the Company, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

We have nothing to report in these respects.

7 Respective responsibilities

Directors' responsibilities
As explained more fully in their statement set out on page 11, the Directors are responsible for: the preparation of the financial statements including being satisfied that they give a true and fair view; such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and using the going concern basis of accounting unless they either intend to liquidate the Company or to cease operations, or have no realistic alternative but to do so.

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

A fuller description of our responsibilities is provided on the FRC's website at www.frc.org.uk/auditorsresponsibilities.

Irregularities – ability to detect
We identified areas of laws and regulations that could reasonably be expected to have a material effect on the financial statements from our general commercial and sector experience, through discussion with the directors (as required by auditing standards), and from inspection of the company's regulatory and legal correspondence and discussed with the directors the policies and procedures regarding compliance with laws and regulations. We communicated identified laws and regulations throughout our team and remained alert to any indications of non-compliance throughout the audit.

The potential effect of these laws and regulations on the financial statements varies considerably.

Firstly, the Company is subject to laws and regulations that directly affect the financial statements including financial reporting legislation (including related companies legislation), distributable profits legislation, and taxation legislation and we assessed the extent of compliance with these laws and regulations as part of our procedures on the related financial statement items.

Secondly, the company is subject to many other laws and regulations where the consequences of non-compliance could have a material effect on amounts or disclosures in the financial statements, for instance through the imposition of fines or litigation or the loss of the company's licence to operate. We identified the following areas as those most likely to have such an effect: regulatory capital recognising the financial and regulated nature of the company's activities. Auditing standards limit the required audit procedures to identify non-compliance with these laws and regulations to enquiry of the directors and inspection of regulatory and legal correspondence, if any. These limited procedures did not identify actual or suspected non-compliance.

Owing to the inherent limitations of an audit, there is an unavoidable risk that we may not have detected some material misstatements in the financial statements, even though we have properly planned and performed our audit in accordance with auditing standards. For example, the further removed non-compliance with laws and regulations (irregularities) is from the events and transactions reflected in the financial statements, the less likely the inherently limited procedures required by auditing standards would identify it. In addition, as with any audit, there remained a higher risk of non-detection of irregularities, as these may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal controls. We are not responsible for preventing non-compliance and cannot be expected to detect non-compliance with all laws and regulations.

Independent Auditor's Report *(continued)*

8 The purpose of our audit work and to whom we owe our responsibilities

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members, as a body, for our audit work, for this report, or for the opinions we have formed.

Andrew Jones

Andrew Jones (Senior Statutory Auditor)
for and on behalf of KPMG LLP, Statutory Auditor
Chartered Accountants

1 St Peter's Square
Manchester
M2 3AE

9 April 2019

Income statement

for the year ended 31 December 2018

	Note	**31 December 2018 £'000**	31 December 2017 £'000
Underwriting revenue			
Gross written premiums	5	**49,529**	52,993
Outward reinsurance premiums	5	**(2,838)**	(3,715)
Change in the gross provision for unearned premiums	20	**(173)**	2,241
Change in the provision for unearned premiums, reinsurers' share	20	**(75)**	(36)
Net earned premiums		**46,443**	51,483
Investment income	6	**1,300**	2,162
Dividends from subsidiaries		**5,897**	9,601
Total revenue		**53,640**	63,246
Expenses			
Gross claims incurred	7	**(40,981)**	(26,777)
Less: claims recoveries from reinsurers	7	**19,919**	8,395
Claims incurred, net of reinsurance		**(21,062)**	(18,382)
Fees, commissions and other acquisition costs	8	**(14,016)**	(15,760)
Operating and administrative expenses		**(14,663)**	(13,615)
Total operating expenses		**(28,679)**	(29,375)
Profit before tax	9	**3,899**	15,489
Income tax	13	**2**	(1,549)
Profit for the year	9	**3,901**	13,940

All income statement transactions relate to continuing operations.

The attached notes form an integral part of these financial statements.

Statement of other comprehensive income
for the year ended 31 December 2018

	31 December 2018 £'000	31 December 2017 £'000
Profit for the year	**3,901**	13,940
Other comprehensive income		
Items that may be reclassified subsequently to income statement:		
Available-for-sale securities - unrealised net changes in fair value	**(2,007)**	(204)
Available-for-sale securities - reclassified to income statement	**55**	(343)
Related tax	**329**	118
Other comprehensive loss for the year, net of income tax	**(1,623)**	(429)
Total comprehensive income for the year	**2,278**	13,511

All comprehensive income transactions relate to continuing operations.

The attached notes form an integral part of these financial statements.

Statement of financial position

as at 31 December 2018

	Notes	**31 December 2018 £'000**	31 December 2017 £'000
Assets			
Financial investments			
Cash and cash equivalents	4	**6,618**	6,075
Short-term bank deposits	4	**2,345**	13,073
Fixed-income securities	4	**99,507**	108,810
Investments in group undertakings		**53,806**	53,806
Total investments		**162,276**	181,764
Insurance debtors - intermediaries	18	**5,903**	6,220
Insurance debtors - out of reinsurance operations	18	**1,861**	1,542
Current tax		**224**	-
Other debtors	18	**768**	201
Ceded unearned premiums	20	**54**	131
Reinsurers' share of insurance contract liabilities	18,20	**28,933**	13,012
Deferred acquisition costs	15	**4,303**	4,062
Prepaid expenses and other assets	18	**1,830**	2,208
Property, plant and equipment	17	**532**	748
Total assets		**206,684**	209,888
Equity and liabilities			
Equity			
Share capital	19	**53,560**	53,560
Capital contribution		**7,062**	7,062
Retained earnings and other reserves		**38,369**	58,107
Total equity		**98,991**	118,729
Liabilities			
Insurance contract liabilities	20	**84,802**	68,658
Creditors arising out of insurance operations	22	**554**	746
Deferred tax liabilities	21	**713**	1,303
Current tax liabilities		**-**	1,326
Accruals and deferred income		**2,534**	2,249
Other liabilities	22	**19,090**	16,877
Total liabilities		**107,693**	91,159
Total equity and liabilities		**206,684**	209,888

The attached notes form an integral part of these financial statements.

The financial statements were approved and authorised for issue by the Board on 9 April 2019 and were signed on its behalf by:

S Worrall
Managing Director

A O'Reilly
Finance Director

HSB Engineering Insurance Limited Registered Number: 2396114

Statement of changes in equity
for the year ended 31 December 2018

	Share capital £'000	Capital contribution £'000	Fair Value reserve £'000	Retained earnings £'000	Total equity £'000
At 1 January 2017	53,560	7,062	1,850	42,746	105,218
Profit for the year	-	-	-	13,940	13,940
Other comprehensive loss	-	-	(429)	-	(429)
Total comprehensive income	-	-	(429)	13,940	13,511
At 31 December 2017	53,560	7,062	1,421	56,686	118,729
Profit for the year	-	-		**3,901**	**3,901**
Other comprehensive loss	-	-	**(1,623)**	-	**(1,623)**
Total comprehensive income	-	-	**(1,623)**	**3,901**	**2,278**
Dividends paid	-	-	-	**(22,016)**	**(22,016)**
At 31 December 2018	**53,560**	**7,062**	**(202)**	**38,571**	**98,991**

The attached notes form an integral part of these financial statements.

Statement of cash flows

for the year ended 31 December 2018

	Note	31 December 2018 £'000	31 December 2017 £'000
Cash flow used in operating activities			
Profit for the year		**3,901**	13,940
Adjustments			
Working capital changes – assets / (liabilities)			
Decrease in insurance debtors - intermediaries		**317**	774
(Increase) / decrease in insurance debtors - out of reinsurance operations		**(319)**	380
(Increase) / decrease in other debtors		**(567)**	159
Decrease in ceded unearned premiums		**77**	38
Increase in reinsurers' share of insurance contract liabilities		**(15,921)**	(6,769)
(Increase) / decrease in deferred acquisition costs		**(241)**	180
Decrease in prepaid expenses and other assets		**378**	152
Increase in insurance contract liabilities		**16,144**	2,264
Decrease in creditors arising out of insurance operations		**(192)**	(1,214)
Increase / (decrease) in accruals and deferred income		**285**	(249)
Increase / (decrease) in other liabilities		**2,213**	(118)
Non-cash items in profit for the year			
Provision for taxes		**(2)**	1,549
Depreciation	17	**216**	286
Amortisation of investment premiums and discounts		**1,413**	1,424
Unrealised foreign exchange differences		**568**	107
Loss / (gain) on disposal of investments		**55**	(370)
Tax paid			
Income taxes paid		**(1,808)**	(1,320)
Net cash inflow from operating activities		**6,517**	11,213
Purchases of property, plant and equipment	17	**-**	(18)
Proceeds from disposal of property, plant and equipment		**-**	28
Purchases of investments		**(57,754)**	(60,501)
Disposals and maturities of investments		**73,807**	45,724
Net cash inflow / (outflow) from investing activities		**16,053**	(14,767)
Dividends paid		**(22,016)**	-
Net cash outflow from financing activities		**(22,016)**	-
Net increase / (decrease) in cash and cash equivalents		**554**	(3,554)
Cash and cash equivalents at beginning of the year		**6,075**	9,571
Effect of exchange rate changes		**(11)**	58
Cash and cash equivalents at end of the year		**6,618**	6,075

The attached notes form an integral part of these financial statements.

Notes to the financial statements
for the year ended 31 December 2018

HSB Engineering Insurance Limited (the "Company") is a private company limited by shares and incorporated, registered and domiciled in England and Wales. The Company operates principally as an insurance company underwriting engineering lines risks primarily located in the United Kingdom and Europe through its UK operation and Republic of Ireland branch. The Company has a wholly owned subsidiary undertaking, The Boiler Inspection and Insurance Company of Canada (BI&I), which underwrites engineering risks in North America, and a wholly owned non-insurance subsidiary company in the UK, HSB Engineering Insurance Services Limited (HSBEISL), which provides inspections and consultancy services on plant and equipment. The Company has no interest in any other undertaking.

The Company is an indirect subsidiary of The Hartford Steam Boiler Inspection and Insurance Company (HSBIIC) which is in turn a subsidiary of Munchener Ruckversicherungs-Gesellschaft Aktiengellschaft (Munich Re), the Company's ultimate parent.

1 Accounting policies

Basis of preparation and statement of compliance
The financial statements the Company have been prepared and approved by the Directors in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB) and as endorsed by the European Union (EU), and those parts of the Companies Act 2006 applicable to those reporting under IFRS.

The financial statements have been prepared on the historical cost basis, except for the measurement at fair value of certain financial instruments.

As permitted by section 401 of the Companies Act 2006, the Company has not prepared group financial statements as the results of the Company and all of its subsidiaries are included in publicly available group financial statements of its ultimate parent Company, Munich Re. The registered office of Munich Re is Koniginstr. 107, Munich, Germany.

The Directors have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future, thus they continue to adopt the going concern basis of accounting in preparing the annual financial statements.

New and revised Standards not yet adopted
A number of new standards are effective from 1 January 2018 but they do not have a material effect on the Company's financial statements. The Company has not been impacted by the introduction of IFRS 15, Revenue from contracts with customers, as this does not apply to insurance revenue.

IFRS 9 Financial Instruments
IFRS 9 replaces IAS 39 Financial Instruments: Recognition and Measurement. IFRS 9 brings together all three aspects of the accounting for financial instruments project: classification and measurement, impairment and hedge accounting. On 12 September 2016, the IASB issued Applying IFRS 9 'Financial Instruments' with IFRS 4 'Insurance Contracts' (Amendments to IFRS 4) allowing entities that issue insurance contracts within the scope of IFRS 4 to defer application of IFRS 9 until 2020. The Company has taken advantage of the deferral approach for IFRS 9 in its financial statements for the year ending 31 December 2018.

During the temporary exemption period the Company is required to provide information on the characteristics of its financial assets, and as such will need to disclose the fair value at the end of the reporting period and the amount of the change in the fair value during the period for the following two groups of financial assets separately:

- Financial assets that would meet the "solely payments of principal and interest" (SPPI) characteristic test in IFRS 9 (but excluding certain financial assets based on measurement criteria being met); and
- All financial assets other than those included in SPPI characteristic test.

In addition, the Company is required to disclose information about the credit characteristics of all financial assets that meet the SPPI test by presenting the gross carrying amounts under IAS 39 aggregated by credit risk rating grades as defined in IFRS 7; and for financial assets that do not have low credit risk as defined in IFRS 9, the fair value and the gross carrying amounts under IAS 39. These are disclosed in note 4.

Notes to the financial statements

1 Accounting policies *(continued)*

The following standards were in issue or revised but not yet effective and have not been early adopted by the Company in preparing the financial statements.

***IFRS 17 Insurance Contracts** (not yet endorsed by the EU)*
In May 2017, the IASB issued IFRS 17, a comprehensive new accounting standard for insurance contracts covering recognition and measurement, presentation and disclosure. Once effective, IFRS 17 will replace IFRS 4 Insurance Contracts. The overall objective of IFRS 17 is to provide an accounting model for insurance contracts that is more useful and consistent for insurers. IFRS 17 covers all relevant accounting aspects of insurance contracts. The core of IFRS 17 is the general model, supplemented by a simplified approach (the premium allocation approach) mainly for short-duration contracts. IFRS 17 is effective for reporting periods beginning on or after 1 January 2022, with comparative figures required. Early application is permitted, provided the entity also applies IFRS 9 and IFRS 15 on or before the date it first applies IFRS 17. The Company plans to apply IFRS 17 on its mandatory effective date. Management is in the process of determining full impact of IFRS 17 on the Company's financial statements.

IFRS 16 Leases
IFRS 16 was issued in January 2016 and it replaces IAS 17 Leases, IFRIC 4 Determining whether an Arrangement contains a Lease, SIC-15 Operating Leases-Incentives and SIC-27 Evaluating the Substance of Transactions Involving the Legal Form of a Lease. IFRS 16 sets out the principles for the recognition, measurement, presentation and disclosure of leases and requires lessees to account for all leases under a single on-balance sheet model similar to the accounting for finance leases under IAS 17. At the commencement date of a lease, a lessee will recognise a liability to make lease payments (i.e., the lease liability) and an asset representing the right to use the underlying asset during the lease term (i.e., the right-of-use asset). Lessees will be required to separately recognise the interest expense on the lease liability and the depreciation expense on the right-of-use asset. IFRS 16 also requires lessees to make more extensive disclosures than under IAS 17. IFRS 16 is effective for annual periods beginning on or after 1 January 2019.

The Company plans to apply IFRS 16 initially on 1 January 2019, using the modified retrospective approach. The Company will elect to apply the standard to contracts that were previously identified as leases applying IAS 17 and IFRIC 4. The Company will therefore not apply the standard to contracts that were not previously identified as containing a lease when applying IAS 17 and IFRIC 4. The Company will elect to use the exemptions proposed by the standard on lease contracts for which the lease terms ends within 12 months as of the date of initial application, and lease contracts for which the underlying asset is of low value.

In summary the impact of IFRS 16 adoption is expected to be as follows:

	£'000
Impact on the statement of financial position (increase/(decrease)) as at 31 December 2018:	
Assets:	
Property, plant and equipment (right of use assets)	**7,714**
Liabilities:	
Lease liabilities	**7,714**
Deferred tax liabilities	**-**
Net impact on equity	**-**
Impact on income statement (increase/(decrease)) for 2018:	
Depreciation expense	**(1,148)**
Finance cost	**(125)**
Lease rentals under IAS 17	**1,469**
Income tax expense	**(33)**
Profit for the year	**163**

The cumulative effect of adopting IFRS 16 will be recognised as an adjustment, if any, to the opening balance of retained earnings at 1 January 2019, with no restatement of comparative information.

Notes to the financial statements

1 Accounting policies *(continued)*

Definition of Material (Amendments to IAS 1 and IAS 8) (expected to be endorsed by the EU before effective date)
The changes from the Definition of Material (Amendments to IAS 1 and IAS 8) all relate to a revised definition of 'material' which is:

> Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity.

The amendments are effective for annual reporting periods beginning on or after 1 January 2020.

Amendments to the Conceptual Framework for Financial Reporting (expected to be endorsed by the EU before effective date)
The Conceptual Framework for Financial Reporting (Conceptual Framework) describes the objective of and concepts for general purpose financial reporting. The revised Conceptual Framework, issued by the IASB in March 2018, includes:

- a new chapter on measurement;
- guidance on reporting financial performance;
- improved definitions of an asset and a liability and guidance supporting these definitions; and
- clarifications in important areas, such as the roles of stewardship, prudence and measurement uncertainty in financial reporting.

The IASB also updated references to the Conceptual Framework in IFRS Standards by issuing Amendments to References to the Conceptual Framework in IFRS Standards.

Other standards in issue or amendments that are not yet effective are not expected to significantly impact the financial statements of the Company.

Use of estimates and assumptions
The preparation of financial statements requires the use of estimates and assumptions that affect the application of policies, the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements. Although these estimates are based on management's best knowledge of current events and actions, actual results ultimately may differ from those estimates.

Information about assumptions used and other sources of estimation uncertainty in applying accounting policies that have the most significant effect on the amounts recognised in the financial statements is disclosed in Note 2.

Functional and presentation currency
These financial statements are presented in Great British Pounds (GBP), which is the Company's functional and presentational currency. Except as otherwise indicated, all financial information presented in GBP has been rounded to the nearest thousand (£000).

Insurance contracts
Insurance contracts are those contracts that transfer significant insurance risk at the inception of the contract. Insurance risk is transferred when the Company agrees to compensate a policyholder if a specified uncertain future event adversely affects the policyholder. Any contracts not meeting the definition of an insurance contract under IFRS are classified as investment or service contracts, as appropriate. The Company has reviewed all the contracts issued to its policyholders and concluded that they all meet the definition of insurance contracts.

Recognition of premium income
Premiums written are accounted for in the period in which the contract is entered into, net of refunds and rebates. Premiums are earned as revenue over the period of the contract and are calculated on a time apportionment basis. Those proportions of premiums written in a year which relate to periods of risk extending beyond the end of the year are carried forward as unearned premiums.

Premiums written exclude insurance premium taxes. Duties levied on premiums and directly related expenses, e.g. commissions, are recognised as an expense. Outward reinsurance premiums are accounted for in the same accounting period as the premiums for the related business.

Notes to the financial statements

1 Accounting policies *(continued)*

Net investment income
Net investment income consists of dividends and interest receivable for the year and realised gains and losses on financial instruments. Dividends on equity securities are recorded as revenue on the ex-dividend date. Interest is recognised in the income statement using the effective interest method.

Claims incurred
Claims incurred include all losses occurring during the year, whether reported or not, related handling costs, where applicable, a reduction for the value of salvage and other recoveries and any adjustments to claims outstanding from previous years. Claims handling costs include all internal and external costs incurred in connection with the negotiation and settlement of claims.

Insurance contract liabilities
The provision for unearned premiums represents the portion of the premiums written relating to periods of insurance coverage subsequent to the end of the reporting period calculated on a time apportionment basis. The change in unearned premiums is taken to the income statement in order that revenue is recognised over the period of risk.

Acquisition costs comprise the direct and indirect costs of obtaining and processing new and existing insurance business. Costs which relate to subsequent financial periods are deferred to the extent that they are recoverable out of future revenue margins. These costs are recognised as deferred acquisition costs. Deferred acquisition costs are amortised on the same basis as the related premiums are earned. The amortisation is taken to the income statement.

The costs of claims notified to the Company at the balance sheet date are estimated on a case by case basis to reflect the individual circumstances of each claim. The ultimate expected cost of claims is projected from this data by reference to statistics which show how estimates of claims incurred in previous periods have developed over time to reflect changes in the underlying estimates of the cost of notified claims and late notifications.

Reinsurance
The amounts that will be recoverable from reinsurers are estimated based upon the gross provisions, having due regard to collectability. Reinsurance recoveries in respect of estimated claims incurred but not reported are assumed to be consistent with the historical pattern of such recoveries, adjusted to reflect changes in the nature and extent of the Company's reinsurance programme over time. The recoverability of reinsurance recoveries is impaired if there is an event that occurs after initial recognition of the reinsurance asset that will impact the amount to be received from the reinsurer. The reinsurers' share of claims incurred, in the income statement, reflects the amounts received or receivable from reinsurers in respect of those claims incurred during the period.

Reinsurance liabilities are primarily premiums payable for reinsurance contracts and are recognised in the income statement as 'Outward reinsurance premiums' and paid when due.

Property, plant and equipment
Property, plant and equipment comprise leasehold properties, fixtures, fittings and equipment (including computer hardware). All classes are stated at cost less accumulated depreciation and accumulated impairment losses, if any. Cost includes expenditure that is directly attributable to the acquisition of the items. Subsequent costs are included in the asset only when it is probable that future economic benefits associated to the item will flow to the Company and the cost can be measured reliably.

Depreciation is calculated on the depreciable amount, which is the cost of an asset, or other amount substituted for cost, less its residual value. Depreciation is recognised in the income statement on the basis set out below, over the estimated useful lives, since this most closely reflects the expected pattern of consumption of the future economic benefits embodied in the asset.

Fixtures and fittings	3 to 10 years straight-line
Computer hardware and software	3 to 5 years straight-line
Leasehold property and improvements	Written off over the life of the lease, to a maximum of 10 years

Depreciation methods, useful lives and residual values are reviewed at each financial year end and adjusted if appropriate.

Cash and cash equivalents
Cash and cash equivalents include cash in hand, cash at bank, deposits held at call with banks, other short-term highly liquid investments with original maturities of three months or less and bank overdrafts.

Notes to the financial statements

1 Accounting policies *(continued)*

Short-term bank deposits
Short-term bank deposits consist of interest-bearing securities that mature within one year of their acquisition and these are measured at fair value.

Financial instruments
IAS 39, *Financial Instruments: Recognition and Measurement* requires the classification of certain financial assets and liabilities into separate categories for which the accounting requirements differ.

The classification depends on the nature and purpose of the financial assets and liabilities, and is determined at the time of initial recognition. The Company classifies financial assets and liabilities into the following categories:

- Investments in debt securities are classified as available-for-sale (AFS)
- All other financial assets are classified as loans and receivables
- Financial liabilities are classified as financial liabilities measured at amortised cost.

Initial recognition
Regular purchases and sales of financial assets are recognised on the trade date. All other financial assets and financial liabilities are recognised on the date that the Company becomes a party to the contractual provisions of the instrument.

All financial assets and liabilities are measured initially at fair value plus transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability.

Available-for-sale debt securities
Subsequent to initial recognition, available-for-sale financial debt securities are measured at fair value. When the fair values of available for sale debt securities recorded in the statement of financial position cannot be measured based on quoted prices in active markets, their fair value is measured using valuation techniques with inputs taken from observable markets. Interest income is recognised in the income statement using the effective interest method. Foreign exchange gains or losses resulting from changes in the amortised cost of available-for-sale debt securities are also recognised in the income statement.

Other fair value changes, including other foreign exchange gains or losses, are recognised in other comprehensive income and accumulated in the fair value reserve. If an available-for-sale investment is sold or impaired, the cumulative gain or loss accumulated in the fair value reserve is reclassified to the income statement.

Loans and receivables
Loan and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Subsequent to initial recognition, loans and receivables (including trade and other receivables, bank balances and cash) are measured at amortised cost using the effective interest method less impairment losses, if any.

Interest income is recognised by applying the effective interest method, except for short-term receivables when the effect of discounting is immaterial. Interest income is recognised in the income statement.

Financial liabilities
Subsequent to initial recognition, financial liabilities are measured at amortised cost using the effective interest method.

Impairment
At each reporting date the Company assesses whether financial assets are impaired. A financial asset is impaired when objective evidence demonstrates that a loss event has occurred after the initial recognition of the asset, and that the loss event has an impact on the future cash flows of the asset that can be estimated reliably. An impairment loss, measured as the difference between the security's fair value and amortised cost, is recognised when the issuer is known to be either in default or in financial difficulty. Determining when an issuer is in financial difficulty requires the use of judgement, and consideration of a number of factors including industry risk factors, financial condition, liquidity position and near-term prospects of the issuer, credit rating declines and a breach of contract. A decline in fair value below amortised cost due to changes in risk-free interest rates does not necessarily represent objective evidence of a loss event.

Notes to the financial statements

1 Accounting policies *(continued)*

Financial instruments (*continued*)

For securities identified as impaired, impairment losses are recognised by reclassifying the losses accumulated in the fair value reserve to the income statement. The cumulative loss that is reclassified from other comprehensive income to the income statement is the difference between the acquisition cost, net of any principal repayment and amortisation, and the current fair value, less any impairment loss recognised previously in the income statement. If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases and the increase can be related objectively to an event occurring after the impairment loss was recognised, the impairment loss is reversed through the income statement.

Impairment losses on loans and receivables are calculated as the difference between the carrying amount and the present value of estimated future cash flows discounted at the asset's original effective interest rate. If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed through the income statement.

Impairment of insurance receivables
Individual receivables which are known to be uncollectible are written off by reducing the carrying amount directly. Receivables are assessed collectively to determine whether there is objective evidence that an impairment has been incurred but not yet been identified. For these receivables the estimated impairment losses are recognised in a separate allowance for doubtful debts. The Company considers that there is evidence of impairment if any of the following indicators are present:

- significant financial difficulties of the debtor;
- probability that the debtor will enter bankruptcy or financial reorganisation; or
- default or delinquency in payments.

Receivables for which an impairment allowance was recognised are written off against the allowance when there is no expectation of recovering additional cash.

Impairment losses are recognised in the income statement within operating and administrative expenses. Subsequent recoveries of amounts previously written off are credited against operating and administrative expenses.

Derecognition
The Company derecognises a financial asset when the contractual rights to the cash flows from the asset expire, or it transfers the financial asset in a transaction in which either substantially all the risks and rewards of ownership of the financial asset are transferred, or in which the Company neither transfers nor retains substantially all the risks and rewards of ownership and does not retain control of the financial asset. Control is not retained if the transferee has the practical ability to sell the asset and is able to exercise that ability unilaterally.

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

Offset of financial assets and financial liabilities
Financial assets and liabilities are offset, and the net amount reported in the Company's statement of financial position, when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or to realise the asset and settle the liability simultaneously.

Impairment of non-financial assets
The Company assesses at each reporting date whether there is an indication that an asset may be impaired. If any such indication exists, or when annual impairment testing for an asset is required, the Company estimates the asset's recoverable amount. An asset's recoverable amount is the higher of an asset's or Cash Generating Unit's (CGU) fair value less costs of disposal and its value in use. The recoverable amount is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets. Where the carrying amount of an asset or CGU exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount. Impairment losses are recognised in the income statement.

A previously recognised impairment loss is reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognised. If that is the case, the carrying amount of the asset is increased to its recoverable amount. That increased amount cannot exceed the carrying amount that would have been determined, net of amortisation, had no impairment loss been recognised for the asset in prior years. Such reversal is recognised in the income statement.

Notes to the financial statements

1 Accounting policies *(continued)*

Leases
Leases, where a significant portion of the risks and rewards of ownership is retained by the lessor, are classified as operating leases. Payments made under operating leases are charged to the income statement on a straight-line basis over the period of the lease. Lease incentives are recognised in the income statement on a straight line basis over the shorter of the lease term and the period ending in a date from which it is expected the prevailing market rental will be payable.

All leases currently engaged by the Company are considered operating leases and no liability is recognised in the statement of financial position.

Dividends
Dividends received from investments in equities are recorded on the date on which the shares are quoted ex-dividend.

Dividends received from the Company's subsidiary undertakings are booked on the date the dividend is received. Interim dividends payable are recognised when paid and final dividends booked as a liability when they are approved by the members of the Company passing a written resolution.

Provisions and contingent liabilities
Provisions are recognised when the Company has a present legal or constructive obligation as a result of past events and it is probable that an outflow of resources, embodying economic benefits, will be required to settle the obligation and a reliable estimate of the amount of the obligation can be made. Where the Company expects a provision to be reimbursed, the reimbursement is recognised as a separate asset, but only when the reimbursement is more probable than not. If the effect is material, the provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects a current market assessment for the time value of money and, where appropriate, the risks specific to the liability.

The Company recognises a provision for onerous contracts when the expected benefits to be derived from a contract are less than the unavoidable costs of meeting the obligations under the contract.

Contingent liabilities are disclosed if there is a possible future obligation as a result of a past event, or if there is a present obligation but either an outflow of resources is not probable or the amount cannot be reliably estimated.

Employee benefits
The Company operates defined contribution plans which receive fixed contributions from the Company. The Company's legal or constructive obligation for these plans is limited to the contributions. The contributions are recognised as an employee benefit expense when they are due. Prepaid contributions are recognised as an asset to the extent that a cash refund or a reduction in the future payments is available.

Termination benefits are recognised as an expense when the Company is committed demonstrably, without realistic possibility of withdrawal, to a formal detailed plan to either terminate employment before the normal retirement date, or to provide termination benefits as a result of an offer made to encourage voluntary redundancy. Termination benefits for voluntary redundancies are recognised as an expense if the Company has made an offer of voluntary redundancy, it is probable that the offer will be accepted, and the number of acceptances can be estimated reliably.

If employee benefits are payable more than 12 months after the reporting period, then they are discounted to their present value.

Taxation
Income tax comprises current and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised in other comprehensive income, in which case it is recognised in the statement of other comprehensive income.

Current tax is the expected tax payable on the taxable result for the period and any adjustment to the tax payable in respect of previous periods.

Deferred tax is provided in full on temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for tax purposes and these differences will be eliminated at a later date with a corresponding effect on taxable income. Deferred tax is measured using tax rates expected to apply when the related deferred tax asset is realised or the deferred tax liability is settled based on tax rates and laws which have been enacted or substantively enacted at the balance sheet date.

Notes to the financial statements

1 Accounting policies *(continued)*

Taxation (*continued*)
Deferred tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised. Deferred tax assets and liabilities are not discounted. Deferred tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority and the Company intends to settle its current tax assets and liabilities on a net basis. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

Foreign currency
Transactions in foreign currencies are initially recorded by the Company at their respective functional currency spot rates at the date the transaction first qualifies for recognition. Monetary assets and liabilities denominated in foreign currencies are translated to the Company's functional currency at the exchange rate at the reporting date. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at the reporting date exchange rates of assets and liabilities denominated in foreign currencies are recognised in the income statement.

2 Accounting judgements and estimates in applying accounting policies

The Company makes judgements, estimates and assumptions that affect the reported amounts of assets and liabilities. Estimates are regularly reviewed and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Judgements relate to decisions about the application of accounting policy.

Significant accounting judgements – insurance risk
Insurance contracts are those contracts that transfer significant insurance risk. Such contracts may also transfer financial risk. The Company considers that all of the contracts it underwrites carry insurance, rather than financial risk.

Significant accounting estimates – the ultimate liability arising from claims outstanding
The estimation of claims incurred but not reported is generally subject to a greater degree of uncertainty than the estimation of the cost of settling claims already notified to the Company, where more information about the claim is generally available. However, engineering and property damage business is 'short tail', in that there generally is not a significant delay between the occurrence of the claim and the claim being reported to the Company. Claims are therefore typically reported relatively quickly after the claim event and so the balance displays low levels of volatility.

Allowance is made, however, for changes in uncertainties which may create distortions in the underlying statistics or which might cause the cost of unsettled claims to increase when compared with the cost of previously settled claims including:

- Changes in the legal environment;
- The effects of inflation;
- Changes in the business mix;
- The impact of large losses;
- Movements in industry benchmarks; and
- Changes in the processes which might accelerate or slowdown the development and / or recording of paid or incurred claims compared with the statistics of previous periods.

The two most critical assumptions as regards to claims provisions are that the past is a reasonable predictor of the likely level of future claims development and that the rating and other models used for current business are a fair reflection of the likely level of ultimate claims to be incurred.

The Directors consider that the provision for gross claims and related reinsurance recoveries are fairly stated on the basis of the information currently available to them. However, the ultimate liability will vary as a result of subsequent information and events and this may result in significant adjustments to the amounts provided.

Adjustments to the amounts of claims provisions established in prior years are reflected in the financial statements in the period in which the adjustments are made. The methods used and the estimates made are regularly reviewed to reflect recent and emerging trends in experience and changes in the risk profile of the business.

Notes to the financial statements

3 Insurance risk

As an insurance business, the Company is exposed to a number of risks, as summarised in the Risk Management section of the Strategic Report. The risk under any one insurance contract is the possibility that the insured event occurs and the uncertainty of the amount and timing of the resulting claim. Factors such as the business and product mix, the external environment including market competition and reinsurance capacity all may vary from year to year, along with the actual frequency, severity and ultimate cost of claims and benefits. This subjects the Company to underwriting and pricing risk (the risk of failing to ensure disciplined risk selection and failing to achieve the required premium), claims reserving risk (the risk of actual claims payments exceeding the amount held as a liability) and reinsurance risk (the risk of failing to access and manage reinsurance capacity at a reasonable price).

a) Underwriting and reinsurance risk

The Company manages underwriting and reinsurance risks through its underwriting strategy, adequate reinsurance arrangements and proactive claims handling. The underwriting strategy aims to ensure that the underwritten risks are well diversified in terms of type and amount of risk and geography.

Pricing for the Company's products is generally based upon historical claims frequencies and claims severity averages and adjusted for inflation. While claims remain the Company's principal cost, the Company also makes allowance in the pricing procedures for acquisition expenses, administration expenses, investment income, the cost of reinsurance and for a profit loading that adequately covers the cost of capital.

Underwriting limits and a range of delegated authorities are in place to enforce appropriate risk selection criteria. The Company generally has the right not to renew individual policies, it can impose deductibles and it has the right to reject the payment of a fraudulent claim.

All of the Company's underwriters have specific licences that set clear parameters for the business they can underwrite, based on the experience of the individual underwriter. Additionally, the Company has a centrally managed forum looking at underwriting trends, reviewing and agreeing underwriting direction and setting policy and directives where appropriate. The Company has a portfolio management process which provides a consistent assessment of each portfolio performance against targets. Under the portfolio management system, targets are tracked to monitor emerging trends, opportunities and risks and, on an annual basis, a review forum of business and underwriting leaders undertake a detailed review of each portfolio utilising this data.

The Company has developed methods of recording exposures and concentrations of risk. This means there is greater control of exposures in high risk areas and enables a prompt response to claims from policyholders should there be a catastrophic event such as an earthquake.

Reinsurance arrangements in place include excess of loss, catastrophe and proportional coverage. The effect of such reinsurance arrangements is that the Company should not suffer total net insurance losses beyond the Company's risk appetite in any one year.

The table below sets out the concentration of insurance contract liabilities by class of business:

	31 December 2018		
	Gross written premiums £'000	**Gross claims outstanding £'000**	**Net claims outstanding £'000**
Direct insurance	**37,658**	**54,613**	**26,295**
Reinsurance acceptances	**11,871**	**5,116**	**4,501**
	49,529	**59,729**	**30,796**

	31 December 2017		
	Gross written premiums £'000	Gross claims outstanding £'000	Net claims outstanding £'000
Direct insurance	42,466	37,128	25,880
Reinsurance acceptances	10,527	6,652	4,888
	52,993	43,780	30,768

The liabilities established could be lower or higher than the ultimate cost of settling the claims arising as a result of differences arising from developments in case reserving for large losses and catastrophes, or from changes in estimates of claims incurred but not reported (IBNR). The level of uncertainty varies depending on the nature of the risks being underwritten.

Notes to the financial statements

3 Insurance risk *(continued)*

A 5% increase or decrease in the gross incurred and net incurred claims ratio would have the following effect on income statement and equity:

	31 December 2018		31 December 2017	
	5% increase £'000	**5% decrease £'000**	5% increase £'000	5% decrease £'000
Impact on profit after tax and equity				
Gross of reinsurance	**(1,999)**	**1,999**	(2,230)	2,230
Net of reinsurance	**(1,881)**	**1,881**	(2,079)	2,079

b) Claims reserving risk

The Company establishes loss reserves to account for the anticipated ultimate costs of all losses and related loss adjustment expenses (LAE) on losses that have already occurred. The Company establishes reserves for reported losses and LAE, as well as for IBNR losses and unallocated loss adjustment expenses (ULAE). Loss reserve estimates are based on known facts and on interpretation of circumstances including experience with similar cases and historical claims payment trends. The Company also considers the development of loss payment trends, levels of unpaid claims, judicial decisions and economic conditions.

4 Financial risk and capital management

The Company is exposed to financial risk through its financial assets, financial liabilities, reinsurance assets and insurance liabilities. In particular, the key financial risk is that the proceeds from its financial assets are not sufficient to fund the obligations arising from its insurance contracts. The most important components of financial risk are market risk (interest rate risk and currency risk) and credit risk.

There has been no change from the prior period in the nature of the financial risks to which the Company is exposed. The Company's management and measurement of financial risks is informed by stress testing techniques.

a) Categories of financial instruments

	31 December 2018		31 December 2017	
	Carrying value £'000	**Fair value £'000**	Carrying value £'000	Fair value £'000
Financial assets				
Available-for-sale				
Short-term bank deposits	**2,345**	**2,345**	13,073	13,073
Fixed-income securities	**99,507**	**99,507**	108,810	108,810
	101,852	**101,852**	121,883	121,883
At amortised cost				
Loan and receivables				
Insurance debtors - intermediaries	**5,903**	**5,903**	6,220	6,220
Insurance debtors - out of reinsurance operations	**1,861**	**1,861**	1,542	1,542
Other debtors	**768**	**768**	201	201
Cash and cash equivalents	**6,618**	**6,618**	6,075	6,075
	15,150	**15,150**	14,038	14,038
Financial liabilities – amortised cost				
Creditors arising out of insurance operations	**554**	**554**	746	746
Other liabilities	**19,090**	**19,090**	16,877	16,877
	19,644	**19,644**	17,623	17,623

For short-term bank deposits, loans and receivables items and financial liabilities items, the carrying amounts approximate to fair value owing to the short-term maturity of these financial instruments. There are no restrictions on cash currently in effect.

Notes to the financial statements

4 Financial risk and capital management (*continued*)

Except for insurance debtors, all financial assets of the Company meet the definition of a group of financial assets with contractual terms that give rise to cash flows that are solely payments of principal and interest on the principal amount outstanding (SPPI) as defined under IFRS 9. The amount of the change in fair value of available for sale financial assets during the year is disclosed in the statement of other comprehensive income. Carrying values of financial assets by risk grades that meet the SPPI criteria of IFRS 9 are disclosed in credit risk disclosures. The short-term bank deposits and cash and cash equivalents had effective interest rates of 0% to 0.5% (2017: 0% to 0.25%).

b) Fair value hierarchy

The Company measures fair value using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. The level in the fair value hierarchy within which the fair value measurement is categorised in its entirety is determined on the basis of the lowest level input that is significant to the fair value measurement. Inputs used in making a fair value measurement are classified as follows:

Level 1: fair values measured using quoted bid prices (unadjusted) in active markets for identical assets or liabilities. This category includes listed debt securities in active markets.

Level 2: fair values measured using observable market information as inputs for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices). This category includes listed debt in a market that is not active and debt securities traded over the counter.

Level 3: fair values measured using internal models without observable market information as inputs.

There were no changes in the valuation techniques during the year compared to those described in the prior year financial statements.

For available-for-sale financial assets, the Company determines whether transfers have occurred between levels of the fair value hierarchy by re-assessing categorisation (based on the lowest level input that is significant to the fair value measurement as a whole) at the end of the reporting period.

	31 December 2018 £'000	31 December 2017 £'000
Available-for-sale securities:		
Level 1	**10,426**	-
Level 2	**91,426**	121,883
	101,852	121,883

The fixed-income securities portfolio consists of a range of mainly fixed interest instruments including government securities, local authority issues, corporate loans and bonds, overseas bonds and other interest-bearing securities.

The fair values of bonds, debentures and asset-backed securities are summarised as follows:

	31 December 2018 £'000	31 December 2017 £'000
Government	**45,369**	46,112
Corporate and others	**54,138**	62,698
	99,507	108,810

c) Interest rate risk

The Company's exposure to interest rate risk arises primarily from movements on financial investments that are measured at fair value and have fixed interest rates, which represent a significant proportion of assets. The Company's investment strategy is set in order to control the impact of interest rate risk on anticipated cash flows and asset values.

4 Financial risk and capital management (*continued*)

c) Interest rate risk (*continued*)

Variable	Change in variable	Increase / (decrease) in other comprehensive income 2018 £'000	2017 £'000
Interest rate risk	-100 basis points	**5,647**	6,664
	+100 basis points	**(4,639)**	(5,613)

The value of fixed income investments will vary inversely with changes in interest rates.

The table above assumes all territories experience the same interest rate movement while holding all other variables constant. There have been no changes from the prior year to the method and assumptions used in preparing the above mentioned sensitivity analysis.

Financial investments with variable interest rates, including cash and cash equivalents, are subject to cash flow interest rate risk. This risk is not significant to the Company.

d) Credit risk

The Company has exposure to credit risk, which is the risk of non-payment of their obligations by counterparties. Areas where the Company is exposed to credit risk are:

- reinsurers' share of insurance liabilities (excluding the provision for unearned premiums) and amounts due from reinsurers in respect of claims already paid;
- deposits held with banks;
- amounts due from insurance intermediaries and policyholders; and
- counterparty default on debt securities.

The following table summarises the Company's exposures to credit risk.

	31 December 2018 £'000	31 December 2017 £'000
Cash and cash equivalents	**6,618**	6,075
Short-term bank deposits	**2,345**	13,073
Fixed-income securities	**99,507**	108,810
Reinsurers' share of insurance contract liabilities	**28,933**	13,012
Insurance debtors - intermediaries	**5,903**	6,220
Insurance debtors - out of reinsurance operations	**1,861**	1,542
Other debtors	**768**	201
Aggregate exposure to credit risk	**145,935**	148,933

Details of Company's insurance debtors and other debtors which are overdue but not impaired are provided in Note 18.

The following table provides information on the gross carrying value of insurance, reinsurance and other debtors:

	31 December 2018		31 December 2017	
	Insurance and reinsurance debtors £'000	Other debtors £'000	Insurance and reinsurance debtors £'000	Other debtors £'000
Neither past due nor impaired	**5,869**	**768**	5,069	201
Past due but not impaired	**2,531**	-	3,403	-
Individually impaired	-	-	-	-
	8,400	**768**	8,472	201

The Company has insurance receivables that are past the due date but not impaired. The Company believes that individual impairment of these assets is not appropriate as the amounts due will be collected through normal credit control procedures.

4 Financial risk and capital management (*continued*)

d) Credit risk (*continued*)

The Company incurs credit risk when transferring insurance risk to an external reinsurer. Good credit standing is an essential factor in the selection of reinsurers, as it limits the default and cash-flow risks. The Company purchases reinsurance from external parties as well as from reinsurers within the HSB Group. All reinsurers that participate in risk transfers from the Company have been approved as acceptable counterparties by the HSB Senior Management and Munich Re Group Security Committee. The Company's largest reinsurance counterparty is The Hartford Steam Boiler Inspection and Insurance Company, a related party with an A.M. Best credit rating of A++, and as at 31 December 2018 its share of insurance contract liabilities was £4,747,000 (2017: £5,732,000).

The Company's cash balances are regularly reviewed to identify the quality of the counterparty bank and to monitor and limit concentrations of risk. The level and age of debtor balances are regularly assessed via monthly credit management reports. These reports are scrutinised to assess exposure in respect of aged or outstanding balances. The Company has no material concentration of credit risk in respect of amounts due from insurance intermediaries and policyholders due to the well-diversified spread of such debtors. The Company's fixed interest instruments consist of corporate bonds with high credit ratings and exposures are regularly monitored.

The following table presents the credit quality of financial assets that are neither past due nor impaired. This is assessed by reference to the credit rating as provided by Standard & Poor's or equivalent.

	31 December 2018					
	AAA	**AA**	**A**	**BBB**	**Not rated**	**Total**
	£'000	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**
Cash and cash equivalents	**-**	**4,216**	**2,402**	**-**	**-**	**6,618**
Short-term bank deposits	**-**	**-**	**2,345**	**-**	**-**	**2,345**
Fixed-income securities	**10,426**	**36,410**	**11,921**	**40,750**	**-**	**99,507**
Reinsurers' share of insurance contract liabilities	**13,542**	**10,368**	**5,023**	**-**	**-**	**28,933**
Insurance debtors - intermediaries	**-**	**-**	**-**	**-**	**4,462**	**4,462**
Insurance debtors - out of reinsurance operations	**-**	**-**	**-**	**-**	**1,407**	**1,407**
Other debtors	**-**	**-**	**-**	**-**	**768**	**768**
Total exposure	**23,968**	**50,994**	**21,691**	**40,750**	**6,637**	**144,040**

	31 December 2017					
	AAA	AA	A	BBB	Not rated	Total
	£'000	£'000	£'000	£'000	£'000	£'000
Cash and cash equivalents	-	3,198	2,877	-	-	6,075
Short-term bank deposits	-	11,915	1,158	-	-	13,073
Fixed-income securities	12,323	36,599	12,605	47,283	-	108,810
Reinsurers' share of insurance contract liabilities	4,141	2,147	6,724	-	-	13,012
Insurance debtors - intermediaries	-	-	-	-	4,062	4,062
Insurance debtors - out of reinsurance operations	-	-	-	-	1,007	1,007
Other debtors	-	-	-	-	201	201
Total exposure	16,464	53,859	23,364	47,283	5,270	146,240

e) Liquidity risk

Liquidity risk is defined as the risk of not being unable to meet the Company's financial obligations as they fall due as a result of insufficient access to liquid funds. The Company could be exposed to liquidity risk if there are insufficient financial resources readily available to pay claims and other business expenses when they fall due. Exposure to liquidity risk is determined based on the carrying values of liabilities reflected in the Company's financial statements.

4 Financial risk and capital management *(continued)*

e) Liquidity risk *(continued)*

The following table presents the maturity profile of the liabilities based on contractual undiscounted payments. Current liabilities are all expected to be settled within 12 months after the year-end date:

	31 December 2018 £'000	31 December 2017 £'000
Current liabilities		
Insurance contract liabilities	**84,802**	68,658
Creditors arising out of insurance operations	**554**	746
Current tax liabilities	**-**	1,326
Other liabilities	**19,090**	16,877
Current liabilities	**104,446**	87,607

The Company maintains a portfolio of highly marketable and diverse financial assets that can be easily liquidated in the event of an unforeseen interruption of cash flow.

The Company assessed the concentration of risk with respect to its liabilities and concluded it to be low.

f) Currency risk

The Company operates internationally and as a result, foreign exchange risk arises from recognised assets and liabilities denominated in a currency other than the functional currency. The Company's major exposure to foreign currency risk within its investment portfolio arises from purchased investments that are denominated in currencies other than GBP. The Company also holds cash balances in foreign currency.

The largest currency exposures with reference to net assets / liabilities are shown below, representing effective diversification of resources.

	31 December 2018 £'000	31 December 2017 £'000
Great British Pound	**86,471**	107,948
Australian Dollar	**9,807**	11,475
Euro	**1,410**	(1,480)
US Dollar	**1,888**	1,250
Other	**(585)**	(464)
Total	**98,991**	118,729

The Company is also exposed to currency risk on both Canadian Dollar and US Dollar due to the investment in its subsidiary, BI&I. This is held on the balance sheet at historic deemed cost of £46,752,000, however, this is not representative of the current underlying net asset value.

The sensitivity of profit or loss and equity to movements in currency risk is shown in the following table:

		Increase / (decrease) in profit or loss		**Increase / (decrease) in Other comprehensive income**	
Variable	**Change in variable**	**2018 £'000**	2017 £'000	**2018 £'000**	2017 £'000
Currency risk	-5%	**(626)**	(539)	**(626)**	(539)
	+5%	**626**	539	**626**	539

The following assumptions have been made in preparing the above sensitivity analysis:
- currency gains and losses arise from a change in the value of GBP against all other currencies moving in parallel; and
- all other variables, in particular interest rates, remain constant ignoring any impact of forecasts.

There have been no changes from the prior year to the method and assumptions used in preparing the above mentioned sensitivity analysis.

Notes to the financial statements

g) Capital management

The Company's primary objectives when managing capital are to:
- comply with the regulators' capital requirements of the markets in which the Company operates; and
- safeguard the Company's ability to continue to meet stakeholders' expectations in accordance with its corporate mission, vision and values.

The Company is subject to insurance solvency regulations in all the territories in which it issues insurance contracts, and capital is managed and evaluated on the basis of regulatory capital.

The Company is required to comply with rules issued by the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA), and to submit returns to the PRA detailing the levels of regulatory capital held. The Company continued to report under Solvency II rules during 2018. The Company sets internal capital standards above the PRA's minimum requirement.

Regulated subsidiaries are restricted in the amount of cash dividends they transfer to the parent entity in order for them to meet their individual minimum capital requirements. Share capital and related information is disclosed in Note 19. The company has met all externally imposed capital requirements throughout the year (2017: met)

5 Net insurance premium revenue

	Gross premiums written		Gross premiums earned	
	31 December 2018 £'000	31 December 2017 £'000	**31 December 2018 £'000**	31 December 2017 £'000
Direct insurance	**37,658**	42,466	**38,641**	44,455
Reinsurance acceptances	**11,871**	10,527	**10,715**	10,779
	49,529	52,993	**49,356**	55,234
Outward reinsurance premiums	**(2,838)**	(3,715)	**(2,913)**	(3,751)
Net premiums	**46,691**	49,278	**46,443**	51,483

6 Investment income

	31 December 2018 £'000	31 December 2017 £'000
Interest income	**3,668**	3,669
Amortisation of investment premiums and discounts	**(1,413)**	(1,424)
Investment expenses	**(206)**	(192)
(Loss)/gain on disposal of investments	**(55)**	342
Foreign exchange	**(694)**	(261)
Other	**-**	28
Investment income	**1,300**	2,162

7 Claims and change in insurance liabilities and reinsurance recoveries

	31 December 2018 £'000	31 December 2017 £'000
Gross claims paid	**24,930**	22,208
Gross changes in provisions for claims	**16,051**	4,569
Reinsurance recoveries on claims paid	**(3,906)**	(1,489)
Reinsurers' share of change in provisions for claims	**(16,013)**	(6,906)
Claims incurred, net of reinsurance	**21,062**	18,382

Notes to the financial statements

8 Fees, commissions and other acquisition costs

	31 December 2018 £'000	31 December 2017 £'000
Fees paid	**4**	27
Commissions paid	**14,251**	15,539
Change in deferred acquisition costs	**(239)**	194
Fees, commissions and other acquisition costs	**14,016**	15,760

9 Profit for the year

	31 December 2018 £'000	31 December 2017 £'000
Profit for the year has been arrived at after charging / (crediting)		
Net foreign exchange differences	**694**	261
Depreciation of property, plant and equipment (Note 17)	**216**	286
Gain on disposal of property, plant and equipment	**-**	(28)
Operating lease rentals	**1,161**	1,212

10 Auditor's remuneration

	31 December 2018 £'000	31 December 2017 £'000
Fees payable to the Company's auditor for the audit of the Company's annual accounts	**121**	123
Fees payable to the Company's auditor and its associates for other audit-related assurance services	**27**	151
Total auditor's remuneration	**148**	274

Amounts disclosed are net of service taxes, where applicable. Other audit-related assurance services include Solvency II and other regulatory audit work.

11 Employee information

Staff costs for all employees comprise:

	31 December 2018 £'000	31 December 2017 £'000
Wages and salaries	**7,441**	7,595
Social security costs	**983**	848
Pension costs	**863**	788
	9,287	9,231

The average number of employees during the year was as follows:

Technical	**38**	37
Administrative and management	**184**	189
	222	226

Notes to the financial statements

12 Directors' emoluments

The aggregate amount of Directors' emoluments was £984,000 for the year to 31 December 2018 (2017: £906,000). Emoluments were as follows:

	31 December 2018				31 December 2017
	Fees and salaries £'000	**Bonus £'000**	**Other benefits £'000**	**Total £'000**	Total £'000
Highest paid director	**195**	**153**	**30**	**378**	363
All directors	**643**	**257**	**84**	**984**	906

Other benefits include pension contributions.

Retirement benefits accrued to three Directors under defined contribution pension schemes (2017: three) and no Director under a defined benefit scheme (2017: none). The remuneration of certain Directors is paid by the Company's intermediate parent undertaking, HSB Group Inc. The Company was recharged £Nil (2017: £Nil) in respect of their services to the Company.

13 Tax expense

The tax amounts charged in the income statement are as follows:

	31 December 2018 £'000	31 December 2017 £'000
Current tax		
- Current year	**(75)**	1,449
- Prior years	**14**	415
- Foreign tax - current tax on income for the period	**296**	432
Deferred tax		
- Temporary differences	**(237)**	(426)
- Prior years	**-**	(321)
Total tax (credit)/expense	**(2)**	1,549

The tax amounts charged/(credited) in other comprehensive income are as follows:

	31 December 2018 £'000	31 December 2017 £'000
Current tax		
- Current year	**24**	39
Deferred tax		
- Temporary differences	**(353)**	(157)
Total tax credit	**(329)**	(118)

Tax on the result before tax differs from the United Kingdom effective rate of corporation tax for the year ended 31 December 2018 of 19.00% (2017: 19.25%). The differences are explained below:

	31 December 2018 £'000	31 December 2017 £'000
(Loss)/profit before tax (excluding dividend income)	**(1,998)**	5,888
Tax calculated at the UK effective rate of tax of 19.00% (2017: 19.25%)	**(380)**	1,133
Factors affecting charge for the year:		
Expenses / (income) not deductible for tax purposes	**68**	(34)
Adjustments to tax charge in respect of prior periods	**14**	94
Change in tax rates	**-**	(76)
Withholding tax suffered on dividend received	**296**	432
Total tax (credit)/expense	**(2)**	1,549

Notes to the financial statements

13 Tax expense *(continued)*

A reduction in the UK corporation tax rate from 20% to 19% (effective from 1 April 2017) was substantively enacted on 26 October 2015. A further reduction to 18% (effective 1 April 2020) was substantively enacted on 26 October 2015 and an additional reduction to 17% (effective 1 April 2020) was substantively enacted on 6 September 2016. This will reduce the Company's future current tax charge accordingly.

14 Dividends

Dividends of £22,016,000 were declared and paid in respect of the year ended 31 December 2018 (2017: £Nil)

The Company's subsidiaries may be subject to restrictions on the amount of dividends they can pay to shareholders as a result of local regulatory requirements. However, based on the information currently available, the Company does not believe that such restrictions materially impact the ability to meet obligations or pay dividends.

15 Deferred acquisition costs

	31 December 2018 £'000	31 December 2017 £'000
At 1 January	**4,062**	4,242
Increase in the period	**14,252**	15,539
Release in the period	**(14,013)**	(15,733)
Exchange differences	**2**	14
At 31 December	**4,303**	4,062

16 Retirement benefit schemes

Defined benefit pension scheme

The Company's subsidiary, HSBEISL, operates a funded defined benefit scheme in the UK administered by a single pension fund. The Company's employees are eligible to participate in that benefit scheme.

The scheme was closed to new members with effect from 31 December 2003 and future accrual of benefits ceased for all members on 30 June 2016. However, participating employees who were active members at 30 June 2016 retain a final salary link, so their pension benefits increase in line with increases in their pensionable salary while they remain in employment with the Company.

Up to 30 June 2016, contributions were paid to the scheme by the members at the rate of 7.00% of pensionable salaries and by the Company at the rate of 12.25% of pensionable salaries plus insurance premiums and administrative expenses. Contributions ceased on closure of the scheme to accrual of benefits.

The net defined benefit asset and related disclosures under IAS 19 have been recognised and disclosed in the financial statements of HSBEISL. During the year net defined benefit cost of £25,000 (2017: £nil) was charged to the Company by its subsidiary, HSBEISL.

Defined contribution pension scheme

The Company operates a defined contribution pension scheme for employees and the contributions paid or accruing to the money purchase scheme during the year were £863,000 (2017: £788,000). The Company has no significant exposure to any other post-retirement benefit obligations. The contributions outstanding to the money purchase scheme as at 31 December 2018 were £93,000 (2017: £1,000).

Notes to the financial statements

17 Property, plant and equipment

	Leasehold property £'000	Fixtures, fittings and equipment £'000	Total £'000
Cost			
At 1 January 2018	**1,437**	**983**	**2,420**
Additions	**-**	**-**	**-**
Disposals	**-**	**-**	**-**
At 31 December 2018	**1,437**	**983**	**2,420**
Accumulated depreciation			
At 1 January 2018	**1,019**	**653**	**1,672**
Charge for the year	**121**	**95**	**216**
Disposals	**-**	**-**	**-**
At 31 December 2018	**1,140**	**748**	**1,888**
Carrying amount at 31 December 2018	**297**	**235**	**532**
Cost			
At 1 January 2017	1,437	965	2,402
Additions	-	18	18
Disposals	-	-	-
At 31 December 2017	1,437	983	2,420
Accumulated depreciation			
At 1 January 2017	841	545	1,386
Charge for the year	178	108	286
Disposals	-	-	-
At 31 December 2017	1,019	653	1,672
Carrying amount at 31 December 2017	418	330	748

Depreciation expense has been charged in other operating and administrative expenses.

18 Other assets

	31 December 2018 £'000	31 December 2017 £'000
Reinsurers' share of insurance contract liabilities	**28,933**	13,012
Insurance debtors - intermediaries	**5,903**	6,220
Insurance debtors - out of reinsurance operations	**1,861**	1,542
Prepaid expenses and other assets	**1,830**	2,208
Other debtors	**768**	201
Total other assets	**39,295**	23,183

All other assets listed in the table above are current.

The Company has recognised a collective impairment decrease of £74,000 (2017: increase of £89,000) in other operating and administrative expenses in the income statement for the collective impairment of its trade and other receivables during the year.

There has been no significant change in the recoverability of insurance receivables, for which no collateral is held. The Directors consider that the amounts are recoverable at their carrying values, which are stated net of an allowance for doubtful debts for those debtors that are collectively determined to be impaired.

	31 December 2018 £'000	31 December 2017 £'000
Allowance for doubtful accounts	**636**	710

18 Other assets (continued)

Included within trade receivables of the Company is £121,000 (2017: £119,000) overdue greater than a year but not impaired. There is an allowance for doubtful accounts against balances overdue at the reporting date from 15% to 75% depending on the age. All other balances are less than one year old. None of the insurance and other debtors have been determined to be individually impaired based on the impairment factors used by the Company.

Concentrations of credit risk with respect to debtors are limited due to the size and spread of the Company's trading base. No further credit risk provision is therefore required in excess of provisions already recognised for doubtful debts. Refer to note 4 for credit risk, its management and measures of credit quality of financial assets that are neither past due nor impaired.

19 Share capital and capital management

	Ordinary shares of US$1 each	
	31 December 2018 US$'000	31 December 2017 US$'000
Issued, authorised, allotted and fully paid	**100,000**	100,000
	Number	Number
Issued, authorised, allotted and fully paid	**100,000,000**	100,000,000

The historic British pounds value of the Company's share capital is £53,560,000 (2017: £53,560,000). Ordinary shares entitle the holder to participate in dividends, and to share in the proceeds of winding up the Company in proportion to the number of and amounts paid on the shares held.

20 Insurance liabilities and reinsurance assets

In the normal course of business, the Company seeks to reduce the loss that may arise from events that cause unfavourable underwriting results by reinsuring certain levels of risk with other insurers. The Company manages underwriting risk by transferring exposures through the use of both excess of loss and treaty reinsurance programmes. During 2018 the Company followed the policy of underwriting and reinsuring contracts of insurance that limited the net exposure of the Company to a maximum amount of US$5m per event and $6.25m per risk (2017: US$5m per event and £2m per risk).

The provision for unpaid claims and adjustment expenses is an estimate subject to variability and the variation could be material in the near term. Variation can be caused by receipt of additional claim information, changes in judicial interpretation of contracts, significant changes in severity or frequency from historical trends, the timing of claims payments, and the recoverability of reinsurance. The estimate is principally based on Company's historical experience. Methods of estimation have been used which the Company believes produce reasonable results given current information.

	31 December 2018 £'000	31 December 2017 £'000
Gross		
Claims outstanding	**59,729**	43,780
Unearned premiums	**25,073**	24,878
Total gross insurance liabilities	**84,802**	68,658
Recoverable from reinsurers		
Claims outstanding	**28,933**	13,012
Unearned premiums	**54**	131
Total reinsurers' share of insurance liabilities	**28,987**	13,143
Net		
Claims outstanding	**30,796**	30,768
Unearned premiums	**25,019**	24,747
Total net insurance liabilities	**55,815**	55,515

20 Insurance liabilities and reinsurance assets *(continued)*

Reserving methodology
The provision for unpaid claims, adjustment expenses and unreported losses is determined using accepted actuarial practices. These include the chain-ladder development factor method, Bornhuetter-Ferguson method and frequency/severity development method. The provision provides for all costs of investigation and settlement of insurance losses that have occurred prior to the year end, as well as an estimate for claims incurred but not reported. Liabilities for unpaid claims are estimated using the input of assessment for individual cases reported and statistical analyses for the claims incurred but not reported.

Uncertainty margins
The Company believes that its overall case reserving and actuarial practices have been consistently applied over many years, and that its provisions have resulted in reasonable approximations of the ultimate cost of claims incurred. The Company assesses the appropriateness of its homogeneous risk groups on an ongoing basis to reflect changes in the business.

Assumptions and changes in assumptions
In performing the valuation of the incurred but not reported liability, the Company makes assumptions as to future loss ratios, trends, reinsurance recoveries, expenses and other contingencies, taking into consideration the circumstances of the Company and the nature of the insurance policies. The assumptions underlying the valuation of provisions for unpaid claims and adjustment expenses are reviewed and updated by the Company on an ongoing basis to reflect recent and emerging trends in experience and changes in the risk profile of the business.

Claims development tables

The following table shows the estimates of cumulative incurred claims, including both claims notified and incurred but not reported (IBNR) for each successive accident year at each reporting date together with cumulative payments to date.

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Gross basis (£'000)										
End of accident year	30,048	30,805	29,542	27,033	24,042	21,491	31,284	30,377	37,123	50,377
1 year later	33,309	24,194	27,116	21,814	22,604	19,052	26,130	24,649	33,838	
2 years later	30,611	24,059	26,253	20,638	18,263	18,716	24,182	22,263		
3 years later	28,487	24,481	25,573	20,155	18,370	17,488	23,427			
4 years later	28,426	24,169	24,183	20,089	17,904	17,188				
5 years later	27,858	23,201	24,166	20,108	17,665					
6 years later	27,633	23,259	23,910	19,520						
7 years later	27,752	23,291	23,721							
8 years later	27,130	23,137								
9 years later	27,029									
Current estimate of cumulative claims	**27,029**	**23,137**	**23,721**	**19,520**	**17,665**	**17,188**	**23,427**	**22,263**	**33,838**	**50,377**
Cumulative payments	**26,586**	**22,778**	**23,496**	**18,408**	**16,673**	**15,619**	**22,058**	**19,932**	**23,312**	**10,428**
Net basis (£'000)										
End of accident year	22,072	18,698	22,441	21,195	18,655	20,427	29,255	27,138	28,561	29,543
1 year later	21,675	16,914	19,902	16,299	16,642	18,142	24,198	21,345	24,307	
2 years later	19,303	16,741	19,822	15,734	14,256	17,937	22,514	19,774		
3 years later	18,121	16,973	19,205	15,170	14,536	16,718	21,772			
4 years later	18,228	16,722	17,910	15,188	14,088	16,437				
5 years later	17,811	15,969	17,842	15,071	13,874					
6 years later	17,539	16,021	17,628	14,527						
7 years later	17,584	16,052	17,502							
8 years later	17,589	15,951								
9 years later	17,518									
Current estimate of cumulative claims	**17,518**	**15,951**	**17,502**	**14,527**	**13,874**	**16,437**	**21,772**	**19,774**	**24,307**	**29,543**
Cumulative Payments	**17,135**	**15,650**	**17,320**	**14,119**	**13,166**	**15,349**	**20,565**	**17,534**	**19,503**	**10,435**

Notes to the financial statements

20 Insurance liabilities and reinsurance assets (*continued*)

Claims development tables (*continued*)

(£'000)	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Total
Net liabilities- last 10 accident years	383	301	182	408	709	1,089	1,207	2,239	4,804	19,109	30,431
Liabilities in respect of prior accident years											365
Liability recoverable from reinsurers											28,933
Gross liabilities in statement of financial position											**59,729**

Provisions for the Company's net claims at the beginning of the year compared to payments and provisions at the end in respect of prior underwriting years liabilities amounted to an overprovision in 2018 of £8,492,000 (2017: £9,344,000 overprovision).

b) Movements in insurance liabilities and reinsurance assets

	Gross £'000	Reinsurance £'000	Net £'000
Claims outstanding			
At 1 January 2018	43,780	(13,012)	30,768
Cash (paid) / received for claims settled in the year	(24,930)	3,906	(21,024)
Change in liabilities/reinsurance assets			
- arising from current year claims	50,376	(20,833)	29,543
- arising from prior year claims	(9,395)	914	(8,481)
Exchange differences	(102)	92	(10)
At 31 December 2018	59,729	(28,933)	30,796
Provision for unearned premiums			
At 1 January 2018	24,878	(131)	24,747
Premiums written in period	49,529	(2,838)	46,691
Premiums earned in the period	(49,356)	2,913	(46,443)
Exchange differences	22	2	24
At 31 December 2018	25,073	(54)	25,019
Claims outstanding			
At 1 January 2017	39,345	(6,243)	33,102
Cash (paid) / received for claims settled in the year	(22,208)	1,489	(20,719)
Change in liabilities/reinsurance assets			
- arising from current year claims	37,123	(8,562)	28,561
- arising from prior year claims	(10,346)	167	(10,179)
Exchange differences	(134)	137	3
At 31 December 2017	43,780	(13,012)	30,768
Provision for unearned premiums			
At 1 January 2017	27,049	(169)	26,880
Premiums written in period	52,993	(3,715)	49,278
Premiums earned in the period	(55,234)	3,751	(51,483)
Exchange differences	70	2	72
At 31 December 2017	24,878	(131)	24,747

Notes to the financial statements

21 Deferred tax

An analysis and reconciliation of the movement of the key components of the net deferred tax liability during the current and prior reporting period is as follows:

£'000	Net balance at 1 January	Recognised in income statement	Recognised in OCI	Net Balance at 31 December
2018				
Equalisation reserve	(1,008)	**252**	**-**	**(756)**
Property, plant and equipment	(69)	**(6)**	**-**	**(75)**
Provisions	147	**(9)**	**-**	**138**
Unrealised losses on investments	(373)	**-**	**353**	**(20)**
Net tax liability	(1,303)	**237**	**353**	**(713)**
2017				
Equalisation reserve	(1,334)	326	-	(1,008)
Property, plant and equipment	(66)	(3)	-	(69)
Provisions	43	104	-	147
Unrealised gains on investments	(850)	320	157	(373)
Net tax liability	(2,207)	747	157	(1,303)

22 Other liabilities

	31 December 2018 £'000	31 December 2017 £'000
Creditors arising out of insurance operations	**554**	746
Amounts owed to group undertaking	**12,166**	10,367
Commissions payable	**5,752**	5,481
Other creditors	**1,172**	1,029
	19,644	17,623

All other liabilities listed in the table above are current.

23 Commitments

Capital commitments

At the year end, the Company had £70,000 of capital commitments (2017: £Nil).

Operating lease commitments

The Company leases premises and vehicles under non-cancellable operating lease agreements. The leases have varying terms, escalation clauses and renewal rights.

The future aggregate minimum lease payments under non-cancellable operating leases on an undiscounted basis are as follows:

	31 December 2018 £'000	31 December 2017 £'000
Within 1 year	**1,469**	1,260
Between 1 and 5 years	**3,642**	3,394
After 5 years	**284**	-
	5,395	4,654

Operating lease rentals are charged to the income statement during the year.

24 Parent and subsidiary undertakings

Ultimate parent company and controlling party
The Company is a wholly-owned subsidiary of EIG Co., which is incorporated and operates in The United States of America. EIG Co.'s registered office is One State Street, Hartford, United States. The Company's ultimate parent and controlling company is Munchener Ruckversicherungs-Gesellschaft Aktiengellschaft (Munich Re), which is incorporated and operates in Germany. Munich Re's registered office is Koniginstr. 107, Munich, Germany. Copies of the consolidated group accounts can be obtained from New London House, 6 London Street, London EC3R 7LP.

The parent company of the smallest and largest group for which group financial statements are drawn up of which the Company is a member is Munich Re. All the Company's subsidiaries listed below are included within Munich Re's consolidated financial statements. Voting rights are in line with the holdings of ordinary shares.

The Company's interest in group undertakings at 31 December 2018 is as follows:

Subsidiary undertakings	Principal activity	Place of incorporation and operation	Address	Class of shares held	Holding of shares by Parent
The Boiler Inspection and Insurance Company of Canada	Insurance company	Canada	390 Bay St, Suite 2000, Toronto, Canada	Ordinary	100%
HSB Engineering Insurance Services Limited	Inspections and consultancy services	United Kingdom	New London House, 6 London St, London	Ordinary	100%

25 Related party transactions

The following summarises the Company's related party transactions in the year:

	31 December 2018 £'000	31 December 2017 £'000
Transactions with HSBIIC:		
Ceded net premium earned	**(1,548)**	(2,049)
Ceded claims and adjustments	**169**	6,201
Assumed claims and adjustments	**(9)**	(13)
Miscellaneous expense	**(1,580)**	(1,374)
Dividends paid	**22,016**	-
Transactions with Munich Re and its affiliates:		
Ceded net premium earned	**(69)**	(116)
Ceded claims and adjustments	**21**	31
Assumed premiums earned	**(66)**	(6)
Commission and fronting expense	**(2)**	(2)
Miscellaneous (expense) / revenue	**112**	23
Parent company transactions with HSBEISL and BI&I:		
Ceded net premium earned	**(9)**	(84)
Commission and fronting expense	**3**	(4)
Operating expenses recharged to subsidiaries	**4,256**	4,708
Liabilities settled by subsidiaries on behalf of the Company	**11,601**	11,982
Dividends received from subsidiaries	**5,897**	9,601

All transactions were conducted in the normal course of operations on terms and conditions that are similar to those transactions with unrelated parties. The transactions are measured at the exchange amount, which is the consideration established and agreed to by the related parties.

Notes to the financial statements

25 Related party transactions (*continued*)

Amounts due from / (to) related parties:
At the end of the year, the amounts that are included in statements of financial position are as follows:

	31 December 2018 £'000	31 December 2017 £'000
Amounts due from / (to) Munich Re and affiliates	**51**	(27)
Amounts due from / (to) HSB IIC and affiliates		
- in relation to net insurance contract liabilities	**4,747**	5,732
- in relation to other transactions	**(708)**	(773)
Amounts due to HSBEISL and BI&I	**(11,458)**	(9,594)

These balances are settled on the same basis as those with unrelated parties and have arisen from the reinsurance transactions and provision of services referred to above.

Outstanding balances at the year-end are unsecured and interest free and settlement occurs in cash. There have been no guarantees provided or received for any related party receivables or payables. For the year ended 31 December 2018, the Company has not recorded any impairment of receivables relating to amounts owed by related parties (2017: £Nil). This assessment is undertaken each financial year through examining the financial position of the related party and the market in which the related party operates.

The Company's transactions and balances with its defined contribution pension scheme are disclosed in Note 16.

Key management personnel compensation

Key management personnel of the Company include all directors and senior officers. Key management personnel compensation comprised the following:

	31 December 2018 £'000	31 December 2017 £'000
Salaries and short-term employee benefits	**748**	771
Post-employment benefits	**61**	69
Other long-term benefits	**49**	32
Directors fees	**126**	105
Total key management personnel compensation	**984**	977

26 Subsequent events

There were no significant events occurring after the balance sheet date that would have a material impact on the Company's results of operations, financial position and cash flows.