Arch Insurance (UK) Limited (formerly Arch Insurance Company (Europe) Limited)

(Registered number 04977362)

Annual Report and Financial Statements
for the year ended 31 December 2019

Contents

Strategic Report

The Directors present their Strategic Report and Directors' Report of Arch Insurance (UK) Limited ("the Company" or "Arch UK") for the year ended 31 December 2019. The Company was formerly known as Arch Insurance Company (Europe) Limited. The Company name was changed on 18 March 2019.

Principal Activities

The Company currently underwrites Energy, Property and Casualty insurance business with a focus on Specialty lines of insurance. The Company operates from its head office in London and its UK Regional offices. We classify our business into underwriting units comprising: accident and health, energy, marine, aviation and transport, fire and other damage to property and third party liability.

On 1 January 2019, a fellow subsidiary company, Arch UK Holdings Limited, completed the acquisition of the UK commercial lines business previously owned by the Ardonagh Group. The Company has entered into a licensing agreement with Arch UK Holdings Limited to renew this newly acquired business for a fee. The acquired business forms the new Arch UK Regional Division, focused on commercial property, casualty, motor, professional liability, personal accident and travel. The new division also benefits from our strong governance and disciplined approach to risk management, as well as diversification with the existing book of business.

Business Review

Our insurance underwriting strategy is to operate in Specialty lines of business in which our underwriting expertise can make a meaningful difference to operating results. Our insurance business focuses on talent-intensive rather than labour-intensive business and seeks to operate profitably across all of the product lines. This means that we underwrite predominantly in the London wholesale insurance markets and also in regional markets, both directly and on a selective delegated underwriting authority basis. To achieve our objectives, our insurance operating principles are to:

- Capitalise on profitable underwriting opportunities;
- Centralise responsibility for underwriting;
- Maintain a disciplined underwriting philosophy;
- Focus on providing superior claims management; and
- Utilise a brokerage distribution system.

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

The rating environment remained challenging during 2019, though we are seeing firmer pricing for some lines of business including Property and Onshore Energy. Our underwriting strategy remained defensive during 2019, reflecting current market conditions. Notwithstanding the competitive environment, the Company has sought to maintain its underwriting discipline and execute its philosophy on superior risk selection. However, the capital of the Company and Group remains available to support growth of any of our lines of business, when it proves likely to deliver a reasonable return on equity.
The Company continues to benefit from a financial strength rating of A2 from Moody's and A+ from Standard & Poor's, Fitch and A.M. Best.

Results

The results for the year ended 31 December 2019 show a loss for the financial year of £10.5 million (2018 loss: £8.0 million). The 2019 underwriting loss pre intra-group reinsurance treaty of £13.2 million (2018 loss: £2.9 million) is mostly driven by higher underwriting expenses of 3.2% as a result of the new UK Regional business. The impact from the intra-group QS and Stop Loss agreements in 2019 resulted in a post quota share underwriting loss of £12.6 million (2018 loss: £8.9 million) offsetting the non-technical gain of £2.1 million (2018 gain: £6.1 million including a dividend from subsidiaries). This is owing to the ceding commission received not covering the internal costs and is considered a cost of capital. There was a £0.1 million tax gain (2018 loss: £5.1 million) for the year.

Strategic Report *(continued)*

Business Review *(continued)*

Results (continued)

The key performance information and metrics below reflects the Company's technical results:

Key Performance Indicators and Metrics	**2019 £m**	**2018 £m**
Gross premiums written	296.1	174.8
Net premiums written	232.1	104.7
Net premiums earned	176.9	98.5
Net claims incurred	(105.2)	(57.3)
Net underwriting expenses	(84.9)	(44.1)
Net underwriting results	(13.2)	(2.9)
Investment return and foreign exchange	2.1	6.1
Net intra-group reinsurance	0.5	(6.1)
Loss before taxation	(10.6)	(2.9)
Taxation	0.1	(5.1)
Loss for the year	(10.5)	(8.0)
Claims ratio	59.5%	58.2%
Expense ratio	48.0%	44.8%
Combined ratio	107.5%	102.9%

Note: Balances up to net underwriting results shown in the table above and the narratives above and below are before the whole account proportional (85%) intra-group reinsurance treaty and a stop loss reinsurance protection with Arch Re, as these are the KPIs used by the Board of Directors. The Financial Statements on page 19 onwards are presented net of intra-group reinsurance and therefore differ from the above.

Premiums written

2019 gross premium written was higher than prior year by £121.3 million (69.4%) primarily as a result of the acquisition of the UK Regional business which generated £104.2 million premium. Excluding UK Regional business and the impact of exchange rate fluctuations (given the large proportion of premium held in USD), gross written premium increased by £14.0 million. The overall increase was impacted by a reduction in premium due to EEA business (£20.7 million in 2019) now being written through the Group's Ireland based entity Arch Insurance (EU) DAC (AIEU) rather than on Company UK paper as a result of Brexit.

Claims incurred

Pre intra-group reinsurance, the loss ratio was 1.3 points higher than 2018 at 59.5% mainly due to lower net favourable reserve development from prior years in 2019 at 4.2% (2018: 8.6%). This was partly offset by lower attritional losses and catastrophe losses in 2019.

Underwriting expenses

The net underwriting expense ratio, made up of the net acquisition expense ratio and the other operating expense ratio, was 48.0% in 2019 compared to 44.8% in 2018. The higher underwriting expense ratio is largely due to operating expenses being incurred on the new UK Regional business, with a lag in earnings.

Investments returns

The net investment return excluding dividend from the subsidiary and foreign exchange difference is £1.6 million in 2019 (2018: £0.3 million). The Company received £nil (2018: £6 million) dividend income from its subsidiary during the year.

Strategic Report *(continued)*

Business Review *(continued)*

Results (continued)

Intra-group reinsurance

The Company has the benefit of a whole account proportional (85%) intra-group reinsurance treaty and a stop loss reinsurance protection with Arch Reinsurance Ltd ("Arch Re"). Arch Re is a Bermuda domiciled company with $13.2 billion of capital (2018: $11.2 billion) as at 31 December 2019. This reinsurance protection enables capital to be provided from Bermuda to support the business written through the Company and achieve an A+ Standard & Poor's rating for the Company. The net income on the whole account intra-group reinsurance treaty and stop loss, before consideration given to the capital benefit, was £0.5 million (2018 loss: £6.1 million).

Corporate and Social Responsibility

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

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

The Company is committed to providing equal opportunities to potential and actual staff providing services under the secondment and service agreement, in all aspects of the services provided. Our policies are not unfairly discriminatory on any grounds relating to selection, training, career development or any other employment matters.

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

Directors' Duties

The Directors of the Company, as those of all UK companies, must act in accordance with a set of general duties. These duties are detailed in section 172 of the UK Companies Act 2006, which is summarised as follows:

'A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to:

- the likely consequences of any decision in the long term,
- the interests of the company's employees,
- the need to foster the company's business relationships with suppliers, customers and others,
- the impact of the company's operations on the community and the environment,
- the desirability of the company maintaining a reputation for high standards of business conduct, and
- the need to act fairly as between members of the company.'

The following paragraphs summarise how the Directors have fulfilled their duties as detailed in section 172 of the UK Companies Act 2006:

Decision Making

The Company's ultimate mission is to generate a positive contribution to the growth in the Tangible Book Value of our ultimate parent company. The Directors support the CEO in this mission by considering any growth opportunities, changes in the business written and changes in the Company's strategic direction carefully against the Company's risk appetite and

Strategic Report *(continued)*

Directors' Duties *(continued)*

mitigate any associated risks through the risk management strategy set out in the "risk management strategy and risk appetite" section below.

In addition, details on our principal risks and uncertainties, and how the Company's risk environment is managed are set out in Note 4 of the financial statements.

Employees

The Company does not have any direct employees. Arch Europe Insurance Service Ltd.'s employees provide services to the Company under the secondment and service agreement.

Regardless, the Company is committed to ensuring that all staff providing services under the secondment and service agreement adhere to the Arch Capital Group Limited ("AGCL") Code of Business Conduct and have the ability to continue their professional development as described in the corporate and social responsibility section above.

The group remains committed to keeping all staff providing services under the secondment and service agreement fully informed about matters relating to the business. The executive team provides regular updates on business development, financial performance and operational changes. The group intranet is continually maintained and provides access to a library of company policies and procedures.

Business Relationships

Our strategy focuses on growth by maximising our return on equity through adherence to uniform underwriting standards, focusing on generating underwriting profit through prudent risk selection and proper pricing across the underwriting cycle. To do this, we need to develop and maintain strong relationships with our brokers, assureds, coverholders claims management service providers and reinsurers.

The Company has implemented a "Customer Conduct Standards Framework", which has been developed to enforce the win-win concept of a culture aimed at supporting fair customer outcomes. Monitoring of the customer conduct standards is steered by the Conduct Risk Taskforce and any pertinent issues are passed to the Product Group and escalated to the Risk Committee and to the Board as appropriate.

By adhering to the Customer Conduct Standards Framework the Company has created a strong brand in the market, leading not only to a continuous stream of new business being generated but also to strong relationships with our reinsurance counterparties.

Relationships with coverholders and claims management service providers are governed by the Company's Outsourcing Policy. Prior to entering into any third party business relationships, a detailed due diligence process is undertaken to ensure that the services provided comply with the Company's existing business strategy and overall risk profile. Ongoing management of these relationships is based on monitoring and reporting guidelines as set out in the Company's Outsourcing Policy, as well as on open conversations with the service providers.

By following the Outsourcing Policy, the Company ensures that robust relationships are built with its service providers, which contribute to the overall strategy and risk profile.

Community and Environment

Over the year, there has been continued focus on the impact of the company's operations on the community and the environment. Environmental, Social and Governance (ESG) has entered the mainstream in recent years as stakeholders evaluate organisations not only to gauge their money-making ability, but also their commitment to making positive change in the world.

Arch has always put value in making a difference in the communities where we live and work, and there is an ever-growing importance of ESG initiatives. Marcy Rathman was named as ACGL Chief ESG Officer in July 2019, with responsibility

Strategic Report *(continued)*

Directors' Duties *(continued)*

for coordinating and managing the oversight of our growing ESG program, which has included the creation of an ESG Steering Committee.

The ESG program will continue to develop over the future and look at a number of areas including social issues and climate change. The Board of Directors will review the output and recommendations of the ESG and will oversee the implementation of any resulting action at the local level. In addition, Stav Tsielepis, AII Chief Risk Officer, was nominated in October 2019 as being responsible for identification and management of financial risks arising from climate change, and a plan has been agreed to continue to monitor this going forwards.

Standards of Business Conduct

To ensure the Company maintains a high standard of business conduct, the Directors of the Company have reviewed and adopted the Code of Business Conduct as set by ACGL. To ensure staff act in accordance with the Code of Business Conduct, Arch UK provides regular training courses to staff providing services to the Company under the secondment and service agreement.

In addition the Company annually reviews and reissues internal whistleblowing and fit and proper policies, which ensure that all staff providing services to the Company under the secondment and service agreement are and continue to be competent, capable and of good repute.

The Company Chairman is responsible for overseeing the assessment of fitness and propriety of all Non-Executive Directors in conjunction with leading the development and monitoring effective implementation of policies and procedures for the induction, training and professional development of all members of the firm's governing body. The assessment of these matters is facilitated by the Human Resources and Compliance Functions and considered by the Nominations Committee of the Board in conjunction with Non-Executive Director performance and the appropriate balance of experience and skill sets in the Board as a whole.

The Company's Risk Management and Compliance Framework has been designed to meet its business management and regulatory obligations to comply with the PRA, FCA and EIOPA requirements. Management has formulated relevant risk polices for the Company's key risks and these support the risk philosophy and corresponding controls.

The Board has delegated the responsibility relating to controls to the Arch UK Risk Committee. This committee is responsible for assessing all risks facing the Company and for installing appropriate controls to manage and or mitigate each risk. The Risk Committee assesses the level of each risk classification and identifies where additional controls or changes to the systems, processes and or controls may be required. Qualitative and quantitative risk assessments are performed, both before and after allowance for existing controls.

Engaging with our Shareholder

The Board is committed to openly engaging with our shareholder, our parent Arch Reinsurance Europe Underwriting Designated Activity Company, as we recognise the importance of a continuing effective dialogue. It is important to us that the shareholder understands our strategy and objectives, so these must be explained clearly, feedback heard and any issues or questions raised properly considered.

To achieve effective communication with our shareholder, we have quarterly review meetings in place, where the Company's quarterly performance is discussed in detail. These meetings are led by the CFO and attended by the management of our shareholder.

Any decisions materially impacting the ultimate parent company's financial results are discussed with our shareholder and ultimate parent prior to execution. John Mentz joined the Board on 18th March 2019 as a representative of AGCL, our ultimate parent, further strengthening the link between the Company and AGCL and enabling real-time dialogue between the entities' management.

Strategic Report *(continued)*

Risk management strategy and risk appetite

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

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

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

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

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

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

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

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

Strategic Report *(continued)*

Principal risks and uncertainties

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

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

Strategic Report *(continued)*

Principal risks and uncertainties *(continued)*

Principal risks	Impact	Strategy, management and mitigation
Ceded reinsurance risk The risk to the Company arises where reinsurance contracts put in place to reduce gross insurance risk do not perform as anticipated.	Adverse impact on the financial results.	The Company's reinsurance programmes are determined from the underwriting team business plans and seek to protect Arch UK capital from an adverse volume or volatility of claims on both a per risk and per event basis. • The Company aims to establish appropriate retention levels and limits of protection that are consistent with keeping within the Board's risk tolerance and achieving the target rates of return; • Provide stable, sustainable core capacity for each product line with non-core reinsurance purchased when market conditions allow; • Comply with the guidance from the ACGL Security Committee after review by Arch UK management; and • The Company also benefits from an internal quota share with Arch Reinsurance Ltd., the level of which is set at 85%.
Operational risk The risks of direct or indirect losses resulting from inadequate or failed internal processes, fraudulent claims or from systems and people, or from external events including changes in the competitor, regulatory or legislative environments.	Adverse events with potential financial, reputational, legal and customer impacts.	Arch UK recognises that certain operational risks are unavoidable and seeks to limit exposure to operational risks through ensuring that an effective infrastructure, robust systems and controls and appropriately experienced and qualified individuals are in place throughout the organisation. • We continually review and enhance many of our operational processes. This includes enhancing our Risk Management framework to integrate risk, business and capital strategies; • We maintain a robust internal control environment; • We maintain a robust risk capture, management and reporting system; and • We recognise the value of our human resources and have appropriate Human Resources ("HR") policies to develop and retain our staff.
Investment risk *Market risk* – the risk of adverse financial impact due to changes in fair values of future cash flows of instruments held in the investment portfolio as a result of changes in interest rates, credit spread and foreign exchange rates. *Credit risk* – the risk of exposure if another party fails to perform its financial obligations, including failing to perform them in a timely manner. *Liquidity risk* – the risk of maintaining insufficient financial resources to meet business obligations as and when they fall due.	Adverse movements due to asset value reduction, mismatch in assets and liabilities, and default of third parties. Inability to meet cash flows under stress.	Arch UK's investment strategy is to protect the value of capital, focusing on assets that we consider are capable of producing a consistent and recurring flow of income over time. Arch UK's liquidity management ensures that a minimum percentage of consolidated investments are held in liquid, short-term money market securities, to ensure that there are sufficient liquid funds available to meet obligations to policyholders and other creditors as they fall due. Our investment portfolio is managed and controlled through: • Investment strategy and guidelines proposed to the Board by the Investment Committee and monitored by the Investment Committee; • Diverse holding of types of assets including geographies, sectors and credit ratings; and • Stress testing and scenario analysis.
Counterparty credit risk We partner with many suppliers and the failure of any of these to perform their financial obligations or perform them in a timely manner could result in a financial loss. The principal area of counterparty risk is our use of inter-company quota share reinsurance as a capital management tool.	Loss due to default of banks, reinsurers, brokers or other third parties.	Arch UK's strategy is to avoid risk of large losses from counterparty failures through prudent counterparty selection and review of credit exposures. • Credit limits are set for counterparties, particularly reinsurers; • Requirement for minimum credit ratings for reinsurers; • Broker credit exposures are monitored by the business; and • The credit risk arising out of the inter-company quota share is managed through use of a trust fund arrangement.

Strategic Report *(continued)*

Principal risks and uncertainties *(continued)*

Principal risks	Impact	Strategy, management and mitigation
Regulatory risk Changes in law and regulations are not identified, understood, or are inappropriately and incorrectly interpreted, or adopted, or business practices are not efficiently modified. Further, there is a risk that current legal or regulatory requirements are not complied with.	Customer impact, financial loss and regulatory censure. Regulatory sanction, legal action or revenue loss.	Arch UK's regulatory risk strategy is to comply with all laws and regulations. • Continued focus on key regulatory issues, including pricing and reserving adequacy during soft market conditions; • We have a constructive and open relationship with our regulators; and • We continue to monitor all regulatory changes as and when they are required by our regulators.
Conduct risk The risk of failing to deliver the appropriate treatment for our customers throughout all stages of the customer journey and that our people fail to behave with integrity.	Potential customer detriment, financial loss and regulatory censure and sanction.	Arch UK's conduct risk strategy is to ensure good customer outcomes: • Our organisational culture prioritises a consistent approach towards customers and the interests of customers are at the heart of how we operate; and • We have developed a robust customer conduct risk management framework to minimise our exposure to conduct risk.
Group and reputational risk We are dependent on the strength of ACGL Group, our reputation with customers and distributors in the sale of products and services. We have entered into various strategic partnerships that are important to the marketing, sale and distribution of our products.	Loss of ACGL Group value negatively impacts our ability to retain and write new business.	Arch UK derives benefits from being part of the ACGL Group. Group risk is primarily managed at the executive level, through building strong relationships with all parties. Arch UK's reputational risk strategy is to protect our brand and reputation. We do this through: • Our brand and reputation risk are regularly reviewed by various governance committees; and • We seek to offer a superior service to customers and to treat customers fairly in line with Financial Conduct Authority ("FCA") principles.
Capital risk The risk of failing to have sufficient capital required to support our underwriting activities.	Company is unable to meet its financial liabilities.	The Company uses the standard formula for setting regulatory capital as well as the internal capital model for setting economic capital: • Recognised stochastic modelling techniques to measure risk exposure; and • Stress and scenario analysis is regularly performed and the results are documented and reconciled to the Board's risk appetite where necessary.
Risks arising out of the COVID-19 Pandemic On 11 March 2020, the World Health Organisation declared a pandemic in relation to the outbreak of the COVID-19 virus. At the point of issuance of the financial statements the pandemic continues to develop and so does its impact on the Company's risks and risk management. In particular, the following areas are exposed to increased risk as a result of the pandemic: • Loss exposure and reserve adequacy; • Valuation of the investment portfolio; • Recoverability of debtor balances; and • Operational Risk.	The Company's capital may be negatively impacted.	Arch UK have evaluated / addressed these risks as follows: • Management is in the process of performing a detailed exposure analysis and whilst the assessment is ongoing, management are not aware of any individually material exposures and also expect overall exposure to be significantly mitigated through the 85% internal quota share agreement. • To gain comfort that the valuation of the investment portfolio as at 31 December 2019 remains realisable with the increased uncertainty arising as a result of the COVID-19 pandemic, a detailed analysis of the portfolio's performance during Q1 was undertaken. The analysis demonstrated that the portfolio valuation as at March 2020 has increased compared to the values disclosed at 31 December 2019, supporting the assumption that the year-end valuation remains realisable. Further, management is satisfied that the investment values would be realised should the decision to liquidate the portfolio be taken.

Strategic Report *(continued)*

Principal risks and uncertainties *(continued)*

Principal risks	Impact	Strategy, management and mitigation
Risks arising out of the COVID-19 Pandemic (continued)		• Whilst the markets have been impacted, they remain open. The Company's portfolio consist of high quality, highly liquid assets. • Management has assessed its largest insurance debtor counterparties. Whilst it is recognised that there is a potential increase in the default risk with those counterparties, currently we have not observed an increase in the level of defaults with these counterparties but continue to monitor the situation. • The Company's largest reinsurance counterparty is Arch Reinsurance Limited through the internal quota share. The reinsurance recoveries are protected through a trust fund arrangement. Management have assessed the underlying assets of the trust fund and are satisfied that the outstanding amounts as at 31 December 2019 would be recoverable. • Arch UK initiated an early working from home policy and closed the offices ahead of government mandated action. As a result, all staff are now successfully working from home. New IT initiatives have been rolled out to facilitate better communication, positively impacting team collaboration. • Currently, there are no reports or indications that business is not being bound in the normal manner. The Company's underwriting teams are reaching out to brokers via phone and video calls and are continuing to bind new business.

Outlook and Future Developments

The company continues to look for opportunities to find acceptable books of business to underwrite without sacrificing underwriting discipline. As noted above, the Company completed the acquisition of the UK commercial lines business on 1 January 2019. The acquired business became the newly formed Arch UK Regional Division, focused on commercial property, casualty, motor, professional liability, personal accident and travel.

The business faced some challenging rating and economic conditions during 2019, which impacted both our underwriting and investment returns. However, we enter 2020 with some optimism where firmer pricing for some lines of business and higher interest rates to underpin our investment returns. There remains high level of uncertainty with political risk threatening global growth through trade wars and protectionism.

This environment means Arch UK must be nimble and flexible, showing a willingness to innovate in terms of distribution and new markets while maintaining underwriting discipline. Our objective is to generate a positive contribution to the growth in the Tangible Book Value (TBV) of our ultimate parent company Arch Capital Group Ltd (ACGL) across our underwriting platforms. Arch UK has tried and tested governance and underwriting controls and there remains a strong emphasis on risk selection and price adequacy

At the point of issuing of the financial statement the COVID-19 pandemic continues to develop. Whilst the impact on the business remains uncertain, the Directors continue to monitor the impact COVID-19 is having with particular focus on incurred losses, the valuation of the Company's investments and the recoverability of the Company's reinsurance assets, all of which are impacted by the increased volatility and uncertainty in the markets.

Management has performed an initial exposure assessment based on the Company's policy wording at the point of issuing the financial statements without taking into consideration any potential future legislative changes, which may affect how the policy wording is interpreted or enforced. Whilst the assessment is ongoing, management is satisfied that the internal quota share, as well as certain external reinsurance treaties, would significantly reduce any future exposure on a net retained basis and therefore the impact to the Company's capital.

Strategic Report *(continued)*

Outlook and Future Developments *(continued)*

The Company's investment portfolio consists largely of government bonds, for which the fair value has remained largely stable. The Company's largest reinsurance recoverable is through the internal quota share arrangement with Arch Reinsurance Limited. Recoveries under this reinsurance arrangement are protected through a trust fund. The situation continues to be monitored.

Brexit

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

As a result:

- We have set up Arch Insurance (EU) DAC (AIEU), a company domiciled in Ireland and authorised by the Irish regulator, the Central Bank of Ireland (CBI).
- We extended AIEU's authorisations to cover the appropriate classes of insurance relating to EEA business previously written on Arch UK paper. This application was approved by the CBI in February 2019.
- AIEU has been able to provide cover on and from 29 March 2019 for EEA policies.
- For all valid claims on EEA policies incepting before 31 December 2020, Arch will apply all legal means and options to ensure that we are able to service our contracts and to pay claims. This includes completion of a Part VII transfer of historical EEA business from AIUK to AIEU expected to be completed by the end of 2020.

The actions set out above have ensured that Arch retain the permission to write business in Europe following the UK's withdrawal.

Climate change

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

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

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

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

Pasquale Leoni
Director
Arch Insurance (UK) Limited (formerly Arch Insurance Company (Europe) Limited)
01 April 2020

Directors' Report

Ownership

The Company is a wholly owned subsidiary of Arch Capital Group Ltd ("ACGL"), a Bermuda-based company with $13.2 billion of shareholder capital at 31 December 2019 (2018: $11.2 billion). ACGL provides insurance, reinsurance and mortgage insurance on a worldwide basis through its operations in Bermuda, the United States of America, Europe, Canada, and Australia. ACGL is listed on the Nasdaq Stock Market.

The Company operated from its head office in London and its UK Regional offices.

Directors

The Directors of the Company during the year and up to the date of signing the financial statements are:

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

The Directors are covered by third party indemnity insurance policies.

Outlook and Future Developments

Please refer to Strategic Report on page 11.

Donations

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

Financial Risk Management

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

Dividend

The Directors do not propose a dividend for the year (2018: £nil).

Directors' Report *(continued)*

Statement of Directors' Responsibilities

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

In preparing the Company annual accounts, the Directors are required to:

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

The Directors confirm they have complied with the above requirements in preparing the annual accounts.

The Directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the Company. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Statement of Disclosure of Information to Auditors

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

- So far as the Director is aware, there is no information relevant to the audit of the Company's annual accounts for the year ended 31 December 2019 of which the auditors are unaware; and
- The Director has taken all the steps that they ought to have taken in their duty as a Director of the Company in order to make themselves aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

Independent Auditors

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

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

Pasquale Leoni
Director
Arch Insurance (UK) Limited (formerly Arch Insurance Company (Europe) Limited)
01 April 2020

Independent auditors' report to the members of Arch Insurance (UK) Limited (formerly Arch Insurance Company (Europe) Limited)

Report on the audit of the financial statements

Opinion

In our opinion, Arch Insurance (UK) Limited's financial statements:

- give a true and fair view of the state of the Company's affairs as at 31 December 2019 and of its loss for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards, comprising FRS 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland", and applicable law); and
- have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements, included within the Annual Report and Financial Statements (the "Annual Report"), which comprise: the Balance Sheet as at 31 December 2019; the Profit and Loss Account: Technical Account - General Business, the Profit and Loss Account: Non-Technical Account, the Statement of Comprehensive Income, and the Statement of Changes in Equity for the year then ended; and the notes to the financial statements, which include a description of the significant accounting policies.

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

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities under ISAs (UK) are further described in the Auditors' responsibilities for the audit of the financial statements section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

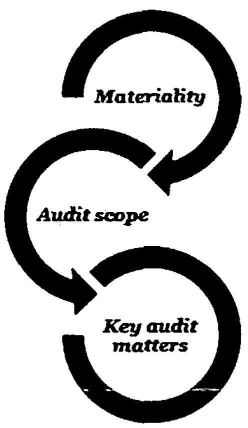
We remained independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, which includes the FRC's Ethical Standard, as applicable to public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

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

Other than those disclosed in note 7 to the financial statements, we have provided no non-audit services to the Company in the period from 1 January 2019 to 31 December 2019.

Our audit approach

Overview



- Overall materiality: £2.96 million (2018: £1.75 million), based on 1% of gross written premiums.

- We performed a full scope statutory audit of the financial statements of Arch Insurance (UK) Limited.

- Estimation of claims reserves
- Estimation of earned premium and the risk of fraud in revenue recognition
- Impact of COVID-19 subsequent event

Independent auditors' report to the members of Arch Insurance (UK) Limited (formerly Arch Insurance Company (Europe) Limited *(continued)*

The scope of our audit

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

Capability of the audit in detecting irregularities, including fraud

Based on our understanding of the Company and industry, we identified that the principal risks of non-compliance with laws and regulations related to breaches of the Financial Conduct Authority's and Prudential Regulation Authority's regulations, and we considered the extent to which non-compliance might have a material effect on the financial statements. We also considered those laws and regulations that have a direct impact on the preparation of the financial statements such as the Companies Act 2006, the Financial Services and Markets Act 2000 and the Solvency II Directive. We evaluated management's incentives and opportunities for fraudulent manipulation of the financial statements (including the risk of override of controls), and determined that the principal risks were related to the estimation of claims reserves, the estimation of earned premium and the risk of fraud in revenue recognition and management override of controls. Audit procedures performed by the engagement team included:

- discussions with the Board, management and internal audit, including consideration of known or suspected instances of non-compliance with laws and regulation and fraud;
- evaluation and testing of the operating effectiveness of management's controls designed to prevent and detect irregularities;
- reviewing and challenging where appropriate the assumptions and judgements made by management in their significant accounting estimates, in particular in relation to the estimation of claims reserves and the estimation of earned premium (see related key audit matters below);
- identifying and testing journal entries, in particular any journal entries with unusual account combinations or posted by unexpected users; and
- designing audit procedures to incorporate unpredictability around the nature, timing or extent of our testing.

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

Key audit matters

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

Key audit matter	***How our audit addressed the key audit matter***
Estimation of claims reserves	
Claims reserves, and in particular IBNR reserves, are a material estimate in the financial statements and their valuation involves a significant degree of judgement. Claims reserve valuation can be materially impacted by numerous factors, including:	We performed a risk assessment of business classes and undertook a combination of independent re-projections, review of methodologies and assumptions, and key indicator reviews over reserves held by reserving category, in accordance with our risk assessment;

Independent auditors' report to the members of Arch Insurance (UK) Limited (formerly Arch Insurance Company (Europe) Limited *(continued)*

Key audit matter	***How our audit addressed the key audit matter***
• the consistency of approach from year to year and any significant movement in reserve strength; • the adequacy of management's process to quantify the impact of large loss events and the degree of uncertainty around those estimates; • the assessment and development of large and catastrophe losses; and • the appropriateness of significant assumptions made and the degree of caution in key areas of uncertainty. There are varying methods that can be adopted in the estimation of claims reserves, which are underpinned by a series of assumptions selected by the Company. These can rely on a large degree of judgement and relatively small changes in the data or assumptions can lead to significant movements in claims reserves. The high degree of subjectivity and sensitivity has warranted these balances being classed as a key audit matter.	We assessed the reasonableness and adequacy of the planned loss ratios by considering past performance (and particularly in the case of the UK Regional portfolio, emerging claims experience), considering management justifications and rationales, and market trends and insights where appropriate; We tested the application of the reinsurance program on the calculation of net reserves; We concluded on the overall strength and consistency of reserves; We performed walkthroughs to understand and evaluate the claims and reserving processes, considering the consistency of case reserving philosophy. In addition, we tested the key controls identified, including reconciliations between claims administration systems and actuarial reports, and actuarial review controls; We sample tested the underlying source data to supporting documentation, including paid and reported claims; and We tested the reserves held for catastrophe losses, including targeted testing of individual large losses that had been reported.
Estimation of earned premium and the risk of fraud in revenue recognition In the context of an insurer, 'revenue' in respect of insurance contracts may reasonably be taken as net earned premiums. Based on our considerations, we have concluded that the significant risk lies primarily within the recognition and measurement of premium estimates, specifically for business written via delegated underwriting authorities. For the majority of premium written via delegated underwriting authorities, amounts are recorded based on bordereaux received, with an accrual being made for premium estimated on subsequent months where the bordereaux has not yet been received. This produces a material premium estimate at the year-end. Accruals are made based on experience and management judgement. There is a risk that differences between the accruals made at year-end and the actual amounts coming through on subsequent bordereaux are materially different. Arch Insurance (UK) Limited holds a new licensing agreement to utilise renewal rights acquired by Arch UK Holdings Limited, referred to as UK Regional. We assessed there to be a potentially heightened risk arising at the first year-end for this business that this income is materially misstated, due to error or judgement or the systems not being fully integrated, resulting in misstatements.	We evaluated and tested the key management controls for monitoring the performance of delegated underwriting authority agreements; We tested premium against bordereaux received during the year; We tested the premium estimate made at the year-end and compared this to the post year-end bordereaux where available to assess the difference between accrued and actual premium. Where not available we have understood and assessed management's estimate, including agreeing inputs to communications from coverholders; We assessed estimated premium at the year-end that arose on new coverholders due to the heightened estimation risk arising from the new relationships; We analysed manual journals made to gross written and earned premium and verified that where judgements have been made they are supported by reliable data. We have also assessed that the assumptions supporting adjustments are reasonable; and We gained an understanding of process and controls over the UK Regional business, and performed separate testing over premium transactions and the data sourced from the material policy administration system for this division.

Independent auditors' report to the members of Arch Insurance (UK) Limited (formerly Arch Insurance Company (Europe) Limited *(continued)*

Key audit matter	***How our audit addressed the key audit matter***
Impact of COVID-19 subsequent event As disclosed in note 23, the World Health Organisation declared a pandemic in relation to the Novel Coronavirus (COVID-19) on 11 March 2020. The outbreak is causing unprecedented social disruption, and global economic and financial markets volatility. The situation at 31 December 2019 was that a limited number of cases of an unknown virus had been reported to the World Health Organisation. The subsequent spread of the virus and its identification as a new coronavirus does not provide additional evidence about the situation that existed at 31 December 2019, and it is therefore considered to be a non-adjusting event. Accordingly, no allowance for losses or other financial impacts has been made in the financial statements. Subsequent to the year end, management have performed procedures to assess the financial and operational impacts of COVID-19 which include: • an assessment of incurred losses and potential insurance risk exposure across impacted classes of business; • an assessment of the impact of market volatility on the valuation and liquidity of the Company's investment portfolio, including an analysis of the portfolio's performance during Q1; • an assessment of credit risk on the Company's largest debtor exposures; and • consideration of the operational risks to the business, including the ability of the Company to continue to write business and operate through implementation of a remote working environment. Management have concluded that the Company's net retained exposure is significantly reduced as a result of the reinsurance arrangements in place, and have not identified the need for asset impairments. They are of the view that the Company will continue to meet its capital requirements and operate through this pandemic. They have concluded, therefore, that the Company continues to be a going concern. However, as the emergence of the situation is in its earlier stages and is rapidly evolving, the full extent of the impact on the Company is uncertain and therefore the financial impacts cannot be reliably estimated at this point in time.	We evaluated management's assessment of the impact of COVID-19 on the Company, and assessed the disclosure included within the Annual Report and Financial Statements, by performing the following procedures: • reviewed management's formal assessment of going concern and discussed this with the Board; • reviewed management's stress and scenario testing in light of the Company's year-end solvency position; • reviewed management's insurance exposure assessment and discussed the key assumptions with Finance and Actuarial, considering consistency with the Company's underlying classes of business and comparing to wider market expectations; • inspected underlying reinsurance contracts and considered the consistency with management's assessment as to how those contracts would interact with potential exposures arising from COVID-19, including the internal 85% quota share arrangement with Arch Reinsurance Limited; • obtained March 2020 valuation reports for the Company's investment portfolio, and the trust fund providing collateral on the reinsurance recoverable from Arch Reinsurance Limited, and considered the level of exposure on these portfolios; • reviewed management's assessment of credit risk on significant debtor exposures and ensured consistency with the disclosures included within the Annual Report; • considered the underwriting impact on the Company and any implications for management's going concern assessment; and • assessed the adequacy of the disclosures made by management within the financial statements in line with the requirements of FRS 102, and checked consistency of these disclosures against our knowledge of the Company based on our audit. Based on the work performed and the evidence obtained, we consider the disclosure of the impact of COVID-19 in the Annual Report and Financial Statements to be appropriate.

Independent auditors' report to the members of Arch Insurance (UK) Limited (formerly Arch Insurance Company (Europe) Limited *(continued)*

How we tailored the audit scope

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

The Company is a UK domiciled insurer that primarily operates through its head office in London, including centralised management and control of its recently acquired UK Regional division. Whilst the UK Regional division has not been determined to be a separate operating segment or financial reporting component, we have understood and evaluated the process and controls in place and performed specific testing procedures over the UK Regional business, including those described within the key audit matters above, due to it being a new revenue source for the Company this year.

Materiality

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

Overall materiality	£2.96 million (2018: £1.75 million).
How we determined it	1% of gross written premiums.
Rationale for benchmark applied	Due to volatility of profits in recent years, we have selected gross written premiums as the benchmark. This is a key performance indicator for users when profitability is less stable, and income has been relatively consistent year on year, reflecting the growth in the Company's operations.

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above £147,955 (2018: £85,000) as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

Conclusions relating to going concern

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

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

However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the Company's ability to continue as a going concern.

Reporting on other information

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

Independent auditors' report to the members of Arch Insurance (UK) Limited (formerly Arch Insurance Company (Europe) Limited *(continued)*

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

With respect to the Strategic Report and Directors' Report, we also considered whether the disclosures required by the UK Companies Act 2006 have been included.

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

Strategic Report and Directors' Report

In our opinion, based on the work undertaken in the course of the audit, the information given in the Strategic Report and Directors' Report for the year ended 31 December 2019 is consistent with the financial statements and has been prepared in accordance with applicable legal requirements.

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

Responsibilities for the financial statements and the audit

Responsibilities of the directors for the financial statements

As explained more fully in the Statement of Directors' Responsibilities set out on page 14, the directors are responsible for the preparation of the financial statements in accordance with the applicable framework and for being satisfied that they give a true and fair view. The directors are also responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error. In preparing the financial statements, the directors are responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Company or to cease operations, or have no realistic alternative but to do so.

Auditors' responsibilities for the audit of the financial statements

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

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

Use of this report

This report, including the opinions, has been prepared for and only for the Company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Independent auditors' report to the members of Arch Insurance (UK) Limited (formerly Arch Insurance Company (Europe) Limited *(continued)*

Other required reporting

Companies Act 2006 exception reporting

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

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

We have no exceptions to report arising from this responsibility.

Appointment

Following the recommendation of the audit committee, we were appointed by the directors on 23 July 2004 to audit the financial statements for the year ended 31 December 2004 and subsequent financial periods. The period of total uninterrupted engagement is 16 years, covering the years ended 31 December 2004 to 31 December 2019.

Kirstie Hanley (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London
01 April 2020

Profit and Loss Account: Technical Account – General Business
For the year ended 31 December 2019

	Notes	2019 £000	2018 £000
Earned premium, net of reinsurance			
Gross premiums written	*6*	296,069	174,822
Outward reinsurance premiums		(262,151)	(159,506)
Net premiums written		**33,918**	**15,316**
Change in the gross provision for unearned premiums		(55,123)	(13,069)
Change in the provision for unearned premiums, reinsurers' share		46,915	12,094
Earned premiums, net of reinsurance		**25,710**	**14,341**
Total technical income		**25,710**	**14,341**
Claims incurred, net of reinsurance			
Claims paid			
- gross amount		(113,070)	(103,803)
- reinsurers' share		105,218	95,443
		(7,852)	(8,360)
Change in the provision for claims			
- gross amount		(26,658)	9,726
- reinsurers' share		22,148	(12,443)
	16	(4,510)	(2,717)
Claims incurred, net of reinsurance		(12,362)	(11,077)
Net operating expenses	*7*	(25,968)	(12,204)
Total technical charges		**(38,330)**	**(23,281)**
Balance on the technical account for general business		**(12,620)**	**(8,940)**

All operations are continuing.

The notes on pages 26 to 53 form part of these financial statements.

Profit and Loss Account: Non-Technical Account

For the year ended 31 December 2019

	Notes	2019 £000	2018 £000
Balance on the general business technical account		(12,620)	(8,940)
Investment income		1,304	6,750
Gains on the realisation of investments		221	-
Unrealised gains on investments		233	-
Investment expenses and charges		(202)	(165)
Losses on the realisation of investments		-	(102)
Unrealised losses on investments		-	(224)
Total investment income	*8*	1,556	6,259
Gain on foreign exchange		838	389
Other expense		(333)	(546)
Loss on ordinary activities before taxation		**(10,559)**	**(2,838)**
Tax on loss on ordinary activities	*10*	96	(5,131)
Loss for the financial year		**(10,463)**	**(7,969)**

Statement of Comprehensive Income

For the year ended 31 December 2019

	Notes	2019 £000	2018 £000
Loss for the financial year		**(10,463)**	**(7,969)**
Other comprehensive income		-	-
Other comprehensive income for the year, net of tax		-	-
Total comprehensive loss for the year		**(10,463)**	**(7,969)**

All results are attributable to continuing operations.

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

The notes on pages 26 to 53 form part of these financial statements.

Balance Sheet
As at 31 December 2019

	Notes	2019 £000	2018 £000
ASSETS			
Investments			
Shares in group undertakings	*12*	30,500	5,000
Shares and other variable-yield securities	*14*	4,510	4,650
Debt securities and other fixed-income securities	*14*	69,177	43,386
		104,187	**53,036**
Reinsurers' share of technical provisions			
Provision for unearned premiums	*16*	118,860	74,672
Claims outstanding		460,665	455,668
	16	**579,525**	**530,340**
Debtors			
Debtors arising out of direct insurance operations		49,696	33,824
Debtors arising out of reinsurance operations		17,256	12,885
Other debtors		5,257	6,397
		72,209	**53,106**
Other assets			
Cash at bank and in hand		30,296	43,382
Deferred tax assets	*15*	-	-
Other assets	*11*	17,552	8,656
		47,848	**52,038**
Prepayments and accrued income			
Deferred acquisition costs		33,498	19,755
Other prepayments and accrued income		1,485	408
		34,983	**20,163**
TOTAL ASSETS		**838,752**	**708,683**
LIABILITIES			
Capital and reserves			
Called up share capital	*17*	50,000	50,000
Other reserves	*18*	42,500	32,500
Profit and loss account		(12,185)	(1,722)
		80,315	**80,778**
Technical provisions			
Provision for unearned premiums	*16*	131,983	79,811
Claims outstanding		506,978	498,475
	16	**638,961**	**578,286**
Provisions for other risks			
Provisions for taxation	*15*	-	-
Creditors			
Creditors arising out of reinsurance operations		54,469	19,508
Other creditors		23,297	4,452
		77,766	**23,960**
Accruals and deferred income	*13*	**41,710**	**25,659**
TOTAL EQUITY AND LIABILITIES		**838,752**	**708,683**

The notes on pages 26 to 54 are an integral part of these financial statements.

The financial statements were approved by the Board of Directors on 30 March 2020 and were signed on its behalf by:

Jason Kittinger
Director
01 April 2020

Statement of Changes in Equity
for the year ended 31 December 2019

	Share capital £000	Other reserves £000	Profit and loss account £000	Total equity £000
Balance at 1 January 2019	**50,000**	**32,500**	**(1,722)**	**80,778**
Capital contribution	-	10,000	-	10,000
Loss for the year	-	-	(10,463)	(10,463)
Total comprehensive loss for the year	**-**	**10,000**	**(10,463)**	**(463)**
Balance at 31 December 2019	**50,000**	**42,500**	**(12,185)**	**80,315**

	Share capital £000	Other reserves £000	Profit and loss account £000	Total equity £000
Balance at 1 January 2018	**50,000**	**-**	**6,247**	**56,247**
Capital contribution	-	32,500	-	32,500
Loss for the year	-	-	(7,969)	(7,969)
Total comprehensive loss for the year	**-**	**32,500**	**(7,969)**	**24,531**
Balance at 31 December 2018	**50,000**	**32,500**	**(1,722)**	**80,778**

The notes on pages 26 to 53 are an integral part of these financial statements.

Notes to the Financial Statements

1 General Information

Arch Insurance (UK) Limited underwrites accident and health, marine, aviation and transport, fire and other damage to property and third party liability insurance business with a focus on Specialty lines of insurance. The Company operates from its head office in London, its UK regional offices.

The company is a private company limited by shares and is incorporated and registered in England and Wales. The address of the Company's registered office is 5th Floor, Plantation Place South, 60 Great Tower Street, London, EC3R 5AZ.

2 Statement of Compliance

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

The Company's financial statements have been prepared in compliance with the provisions of *The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations* relating to insurance groups.

The Company is a wholly owned subsidiary of Arch Reinsurance Europe Underwriting Designated Activity Company and its ultimate parent, Arch Capital Group Ltd. It is included in the consolidated financial statements of Arch Capital Group Ltd., which are publicly available. Consequently, the company has taken advantage of the exemption from preparing consolidated financial statements under the terms of Section 401 of the Companies Act 2006.

These financial statements present information about the Company as an individual undertaking and not about its Group.

3 Significant Accounting Policies

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

(a) Basis of preparation

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

The preparation of financial statements in conformity with FRS 102 requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Company's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the financial statements, are disclosed in Note 5.

(b) Going Concern

The Directors have an expectation that, despite the current uncertainties arising from the COVID-19 pandemic, the Company has adequate resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the financial statements.

(c) Exemptions for qualifying entities under FRS 102

The Company's financial results are included in the consolidated financial statements of Arch Capital Group Ltd. As permitted by FRS 102, the Company has taken advantage of some of the disclosure exemptions available under the FRS 102 section 1.12.

The Company has taken advantage of the following exemptions:

(i) The requirements of Section 7 *'Statement of Cash Flows'* and Section 3 *'Financial Statement Presentation'* paragraph 3.17(d), on the basis that the Company is a qualifying entity and the consolidated statement of cash flows included in the consolidated financial statements of its ultimate parent company includes the Company's cash flows;

Notes to the Financial Statements *(continued)*

3 Significant Accounting Policies *(continued)*

(c) Exemptions for qualifying entities under FRS 102 *(continued)*

(ii) The requirement of Section 33 *'Related Party Disclosures'* paragraph 33.7 (key management compensation).

(d) Foreign Currency

(i) Functional and presentation currency

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

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

(ii) Foreign currency

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

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

(e) Insurance Contracts

(i) Classification

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

(ii) Recognition and measurement

Revenue

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

The earned proportion of premiums is recognised as revenue. Premiums are earned from the date of inception of risk mostly on a time apportionment basis. In the opinion of the Directors the resulting earned proportion is not materially different from one based on the pattern of incidence of risk. For lines of business where the earned proportion would be materially different a pattern based on incident of risk is applied.

Outwards Reinsurance

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

Reinsurance commission income

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

Notes to the Financial Statements *(continued)*

3 Significant Accounting Policies *(continued)*

(e) Insurance Contracts *(continued)*

Unearned premium provisions

Unearned premiums represent the proportion of premiums written in the year and previous years that relate to unexpired terms of policies in force at the balance sheet date calculated on the basis of the earning pattern applied which reflects the underlying risk exposure. Where premiums have been earned on a time apportionment basis, it is the Directors' opinion that the resulting provision is not materially different from one based on the pattern of incidence of risk.

Claims

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

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

We select the initial expected loss and loss adjustment expense ratios based on information derived from our underwriters and actuaries during the initial pricing of the business, supplemented by industry data where appropriate. These ratios consider, amongst other things, rate changes and changes in terms and conditions that have been observed in the market.

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

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

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

Unexpired Risk Provision

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

Notes to the Financial Statements *(continued)*

3 Significant Accounting Policies *(continued)*

(e) Insurance Contracts *(continued)*

(iii) Reinsurance assets and liabilities

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

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

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

(iv) Deferred acquisition costs

Acquisition costs which represent commission and other underwriting related expenses are deferred over the period in which the related premiums are earned. To the extent that acquisition costs are deferred and considered irrecoverable against the related unearned premiums, they are written off to net operating expenses as incurred.

The deferred acquisition cost represents the proportion of acquisition costs which corresponds to unearned portion of gross premiums at the balance sheet date. The deferred acquisition costs are expensed to the profit and loss from the date of inception of risk on mostly a time apportionment basis. For lines of business where using a time apportionment basis would lead to a materially different result to applying a pattern based on incident of risk, the risk-based earning pattern is applied.

(f) Financial Instruments

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

(i) Financial assets

Basic financial assets, including investments in equity and debt securities, loans, trade receivables and cash and cash equivalents, are initially recognised at transaction price, unless the arrangement constitutes a financing transaction, where the transaction is measured at the present value of the future receipts discounted at market rate of interest. As at 31 December 2019 none of the Company's financial assets constitutes a financing transaction and therefore assets were initially recognised at transaction price.

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

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

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

Notes to the Financial Statements *(continued)*

3 Significant Accounting Policies *(continued)*

(f) Financial Instruments *(continued)*

(i) Financial assets (continued)

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

The Company's investments in debt securities are classified as fair value through profit and loss financial assets. These are initially recognised at fair value, which is normally the transaction price. Subsequent to initial recognition, they are measured at fair value and changes therein are recognised in the profit and loss account.

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

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

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

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

(ii) Financial Liabilities

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

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

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

(iii) Offsetting

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

(g) Cash and cash equivalents

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

(h) Taxation

The tax expense for the period comprises current and deferred tax recognised in the reporting period. Tax is recognised in the profit and loss account, except to the extent that it relates to items recognised in other comprehensive income or directly in equity, in which case tax is also recognised in other comprehensive income or directly in equity, as the case may be.

Current or deferred tax assets and liabilities are not discounted.

Notes to the Financial Statements *(continued)*

3 Significant Accounting Policies *(continued)*

(h) Taxation *(continued)*

(i) *Current tax*

Current tax is the amount of income tax payable or receivable in respect of the taxable profit for the year or prior years. Current tax liabilities (assets) are measured at the amount of tax expected to be paid (recovered) using the tax rates and laws that have been enacted or substantively enacted by the balance sheet date.

Management periodically evaluates the positions taken in tax returns with regard to situations in which applicable tax regulation is subject to interpretation and, where appropriate, establishes provisions on the basis of the amounts expected to be paid to the relevant tax authorities.

(ii) *Deferred tax*

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

Deferred tax is recognised in respect of all timing differences at the balance sheet date, with certain exceptions. For instance, unrelieved tax losses and other deferred tax assets are recognised only to the extent that it is probable that they will be recovered against the reversal of deferred tax liabilities or other future taxable profits.

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

Deferred tax assets and liabilities are offset if, and only if, there is a legally enforceable right to set off current tax assets against current tax liabilities and they relate to income taxes levied by the same tax authority on the same taxable entity.

(i) Called up share capital

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

4 Management of Risk

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

(a) Strategic Risk

This is the risk that the Company's strategy is inappropriate or that the Company is unable to implement its strategy. Where events supersede the Company's strategic plan this is escalated at the earliest opportunity through the Company's monitoring tools and governance structure.

On a day-to-day basis, the Company's management structure encourages organisational flexibility and adaptability, while ensuring that activities are appropriately coordinated and controlled. Staff, management and outsourced service providers are expected to excel in service and quality. Individuals and teams are also expected to transact their activities in an open and transparent way and the annual performance reviews will evaluate individuals against these expectations. These behavioural expectations reaffirm our low risk tolerance by aligning interests of all stakeholders.

Notes to the Financial Statements *(continued)*

4 Management of Risk *(continued)*

(b) Insurance Risk

(i) *Underwriting Risk*

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

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

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

The Company has large aggregate exposures to natural and man-made catastrophic events. These risks are inherently uncertain as it is difficult to predict the timing of such events with statistical certainty or estimate the amount of loss which any given occurrence will generate. The Company regularly monitors its exposure to catastrophic events, including earthquake, wind and terrorism, using a catastrophe modelling tool ("AIR") system (Property, Terrorism and Onshore Energy) and the SEQUEL system (Offshore Energy), both locally and at ACGL Group level. Additionally, the Company regularly monitors its exposure to man-made realistic disaster scenarios using both a series of prescribed scenarios and also various bespoke scenarios based on the business written.

The Company seeks to limit its loss exposure by purchasing reinsurance to limit exposure to certain extreme events. The Company also seeks to limit its loss exposure by geographic diversification.

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

Territory	Peril	2019 Gross £m	2019 Net £m
United Kingdom	Tropical Cyclone	97.4	11.2
United Kingdom	Flood	56.3	5.2
Unites States	Tropical Cyclone	61.9	5.2
Europe	Earthquake	20.3	1.8
Unites States	Earthquake	19.5	1.2
South America	Earthquake	11.2	1.1
Mexico	Earthquake	12.7	1.0
Caribbean	Earthquake	9.5	0.8
Mexico	Tropical Cyclone	7.0	0.8
Australia	Tropical Cyclone	10.5	0.8

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

Notes to the Financial Statements *(continued)*

4 Management of Risk *(continued)*

(b) Insurance Risk *(continued)*

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

(ii) *Reserving and Claims Risks*

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

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

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

	Claims inflation assumption £000		**Claims handling expenses £000**		**Number of IBNR claims £000**	
	+5% increase	**-5% reduction**	**+10% increase**	**-10% reduction**	**+5% increase**	**-5% reduction**
2019 Impact on profit after tax and equity						
Gross of Reinsurance	(25,362)	25,362	(650)	650	(13,250)	13,250
Net of Reinsurance	(2,328)	2,328	(650)	650	(1,256)	1,256
2018 Impact on profit after tax and equity						
Gross of Reinsurance	(25,168)	25,168	(475)	475	(12,568)	12,568
Net of Reinsurance	(2,384)	2,384	(475)	475	(1,190)	1,190

(iii) *Ceded Reinsurance Risk*

Reinsurance risk to the Company arises where reinsurance contracts put in place to reduce gross insurance risk do not perform as anticipated, resulting in coverage disputes, or prove inadequate in terms of the vertical or horizontal limits purchased. The Company's reinsurance programmes are determined from the underwriting team business plans and seek to protect Company capital from an adverse volume or volatility of claims on both a per risk and per event basis. In 2019, the Company bought a combination of proportional and non-proportional reinsurance treaties and facultative reinsurance to reduce the maximum net exposure. The Company aims to establish appropriate retention levels and limits of protection that are consistent with keeping within the Board's risk tolerance and achieving the target rates of return. The efficacy of protection sought is assessed against the cost of reinsurance, taking into consideration current and expected market conditions.

Notes to the Financial Statements *(continued)*

4 Management of Risk *(continued)*

(b) Insurance Risk *(continued)*

The Company's reinsurance philosophy is to:

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

The Company also benefits from an internal quota share with Arch Re, the level of which is set at 85%. In addition, there is also an internal stop loss with Arch Re providing $25.0 million cover in excess of 100% ultimate Net Loss Ratio.

(c) Operational Risk

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

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

The operational risk profile is reviewed by the Risk Committee and the controls to mitigate the risks are included in the Risk Register. Risk owners report to the Risk Committee to review the relevant risks and are responsible for identifying new, emerging or changing risks and any subsequent control changes required to realign the risks with the risk appetite.

Notes to the Financial Statements *(continued)*

4 Management of Risk *(continued)*

(c) Operational Risk *(continued)*

When measuring operational risk both quantitative factors, in the form of the probable loss, and qualitative factors, in the form of an assessment of the likely reputational impact or the ability of Arch UK to deliver its service, are taken into account and contribute to determining the risk tolerance.

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

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

(d) Market Risk

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

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

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

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

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

(i) *Interest Rate shift in basis Points*

Interest rate risk	**2019**	**2018**
	£000	**£000**
Impact of 50 basis point increase on result	(816)	(505)
Impact of 50 basis point decrease on result	816	505
Impact of 50 basis point increase on net assets	(816)	(505)
Impact of 50 basis point decrease on net assets	816	505

The Company is exposed to currency risk in respect of liabilities under insurance policies and reinsurance recoverable debtors under reinsurance policies, denominated in currencies other than Sterling. The most significant currencies to which the Company is exposed are the U.S. Dollar ("USD"), the Euro ("EUR") and the Australian Dollar ("AUD").

Notes to the Financial Statements *(continued)*

4 Management of Risk *(continued)*

(d) Market Risk *(continued)*

The Company seeks to mitigate the risk by matching the estimated foreign currency denominated liabilities with assets denominated in the same currency. Assets and liabilities are appropriately matched and as such, movements in the exchange rates between Sterling, U.S. Dollar, Australian Dollar and the Euro have minimal impact on the net result of the Company.

(ii) *Exchange Sensitivity Analysis*

The Company reviews currency asset and liability positions on a regular basis. The currency net assets / (liabilities) positions denote the Company's foreign exchange risk as a result of the translation of subordinated currency positions that are different to the reporting currency of the Company. The main subordinate trading currencies are Euros, United States Dollars and Australian Dollars. The following table describes the net assets / (liabilities) positions at the year end, together with the sensitivity to currency change.

	EUR Net Assets in GBP			USD Net Assets in GBP			AUD Net Assets in GBP		
	£000	+10% increase	-10% decrease	£000	+10% increase	-10% decrease	£000	+10% increase	-10% decrease
Net assets / (liabilities) at 31 December 2019	(3,377)	(338)	338	22,798	2,280	(2,280)	2,275	228	(228)
Net assets / (liabilities) at 31 December 2018	5,294	529	(529)	(386)	(39)	39	472	47	(47)

The increase shown in the table above reflects the strengthening of the currency shown against Sterling and a decrease reflects the weakening of the currency against Sterling.

The Company manages the impact of currency fluctuations by attempting to ensure currency matching is maintained where feasible. In addition, as part of this process, currency trades may be made to maintain the desired currency net asset allocations. The Company has established foreign exchange facilities with a number of banks to cater for these transactions. The Company does not use any foreign exchange derivative contracts.

(e) Credit Risk

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

To lessen the risk of the Company's exposure to any particular reinsurer, exposure limits by class of business are approved. On behalf of the Company, ACGL has developed processes to formally examine all reinsurers before entering into new business arrangements. New reinsurers are approved by the ACGL Reinsurance Steering Committee. The Company's Risk Committee also monitors and reviews the credit ratings of reinsurers in the context of Arch UK's financial position.

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

Notes to the Financial Statements *(continued)*

4 Management of Risk *(continued)*

(e) Credit Risk *(continued)*

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

(i) *Credit distribution of invested assets and cash*

	2019	2019	2018	2018
Standard & Poor's	**£000**	**%**	**£000**	**%**
AAA	20,087	19.3%	11,698	12.8%
AA	33,115	31.9%	16,510	18.1%
A	12,695	12.2%	8,646	9.5%
BAA	-	0.0%	-	0.0%
BBB	2,494	2.4%	1,506	1.6%
NR	2,125	2.0%	6,931	7.6%
Cash at bank and in hand	30,296	29.1%	43,382	47.4%
Cash equivalents	3,172	3.1%	2,745	3.0%
Total	**103,984**	**100.0%**	**91,418**	**100.0%**

The following is a breakdown of amounts owed by reinsurers by A.M. Best financial strength rating at 31 December 2019. The amounts include the total amounts due from reinsurers', including claims outstanding and receivables arising from reinsurance contracts.

	2019	2019	2018	2018
	£000	**% of Total**	**£000**	**% of Total**
A++	5,183	0.9%	5,808	1.1%
A+	476,697	82.3%	409,241	77.2%
A	92,739	16.0%	113,509	21.4%
A-	1,451	0.2%	1,652	0.3%
NR	3,455	0.6%	130	0.0%
	579,525	**100.0%**	**530,340**	**100.0%**

The largest single Reinsurer counterparty is Arch Re in respect of the internal quota share reinsurance. The reinsurance balance with Arch Re is included within the balance that has a credit rating of 'A+'. The balances due from Arch Re have further security in the form of a segregated trust to secure the liabilities. The value of the trust fund is required to be greater than the reinsured net liabilities at all times and the assets in trust are required to be invested to meet the Company's investment guidelines.

Historically we have had no recoverability issues.

Notes to the Financial Statements *(continued)*

4 Management of Risk *(continued)*

(e) Credit Risk *(continued)*

Credit Risk – Ageing and Impairment

Financial assets that are past due but not impaired

		Financial assets that are past due but not impaired					
	Neither due nor impaired	Up to three months	Three to six months	Six months to one year	Greater than one year	Financial assets that have been impaired	Total
	£000	£000	£000	£000	£000	£000	£000
2019							
Shares and other variable-yield securities and unit trusts	4,510	-	-	-	-	-	4,510
Debt securities	69,177	-	-	-	-	-	69,177
Reinsurers' share of claims outstanding	460,665	-	-	-	-	-	460,665
Reinsurance debtors	17,256	-	-	-	-	-	17,256
Insurance debtors	24,950	17,666	2,893	3,802	385	-	49,696
Other debtors	5,257	-	-	-	-	-	5,257
Cash at bank and in hand	30,296	-	-	-	-	-	30,296
Total credit risk	**612,111**	**17,666**	**2,893**	**3,802**	**385**	**-**	**636,857**

		Financial assets that are past due but not impaired					
	Neither due nor impaired	Up to three months	Three to six months	Six months to one year	Greater than one year	Financial assets that have been impaired	Total
	£000	£000	£000	£000	£000	£000	£000
2018							
Shares and other variable-yield securities and unit trusts	4,650	-	-	-	-	-	4,650
Debt securities	43,386	-	-	-	-	-	43,386
Reinsurers' share of claims outstanding	455,668	-	-	-	-	-	455,668
Reinsurance debtors	12,885	-	-	-	-	-	12,885
Insurance debtors	23,358	6,193	2,792	813	668	-	33,824
Other debtors	6,397	-	-	-	-	-	6,397
Cash at bank and in hand	43,382	-	-	-	-	-	43,382
Total credit risk	**589,726**	**6,193**	**2,792**	**813**	**668**	**-**	**600,192**

Notes to the Financial Statements *(continued)*

4 Management of Risk *(continued)*

(f) Liquidity Risk

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

The Company is exposed to daily calls on its available cash resources, principally from claims arising from its insurance business. Liquidity risk arises where cash may not be available to pay obligations when due and maintain a liquidity position. The Company's approach is to manage its cash flows so that it can reasonably survive a significant loss event. This means that the Company maintains sufficient liquid assets, or assets that can be translated into liquid assets at short notice, to meet expected cash flow requirements. These liquid funds are regularly monitored using cash flow forecasting to ensure that surplus funds are invested to achieve a higher rate of return. Regular cash flow monitoring ensures that maturing deposits are sufficient to meet cash calls. Additionally, intra-group reinsurance obligations are secured by funds deposited into a trust account to fund an amount equal to at least 100% of the obligations to the Company.

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

Our investment policy recognises the demands created by our underwriting strategy, so that some investments may need to be realised before maturity or at short notice. Hence a high proportion of our investments are in liquid assets, which reduces our risk of making losses because we may have to sell assets quickly. We do not hold any derivative financial liabilities.

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

	GBP £000	USD £000	EUR £000	AUD £000	Total £000
2019					
Financial investments	104,187	-	-	-	104,187
Reinsurers' share of technical provisions	200,565	167,327	201,158	10,475	579,525
Insurance and reinsurance receivables	36,380	59,431	12,101	(720)	107,192
Cash at bank and in hand	20,082	4,752	4,618	844	30,296
Other assets	10,453	2,097	5,002	-	17,552
Total assets	**371,667**	**233,607**	**222,879**	**10,599**	**838,752**
Technical provisions	234,325	178,242	218,573	7,821	638,961
Insurance and reinsurance payables	50,329	38,570	6,777	503	96,179
Other creditors	28,394	(6,003)	906	-	23,297
Total liabilities	**313,048**	**210,809**	**226,256**	**8,324**	**758,437**

	GBP £000	USD £000	EUR £000	AUD £000	Total £000
2018					
Financial investments	43,059	9,977	-	-	53,036
Reinsurers' share of technical provisions	136,559	157,389	227,292	9,100	530,340
Insurance and reinsurance receivables	27,524	21,050	23,257	1,438	73,269
Cash at bank and in hand	38,651	1,246	3,237	248	43,382
Other assets	4,929	569	3,158	-	8,656
Total assets	**250,722**	**190,231**	**256,944**	**10,786**	**708,683**
Technical provisions	154,617	175,144	240,298	8,227	578,286
Insurance and reinsurance payables	14,707	20,924	9,569	(33)	45,167
Other creditors	6,000	(5,451)	1,783	2,120	4,452
Total liabilities	**175,324**	**190,617**	**251,650**	**10,314**	**627,905**

Notes to the Financial Statements *(continued)*

4 Management of Risk *(continued)*

(g) Counterparty Risk

Arch UK's strategy is to avoid risk of large losses from counterparty failures through prudent counterparty selection and review of credit exposures. We partner with many suppliers and the failure of any of these to perform their financial obligations or perform them in a timely manner could result in a financial loss. Other concentrations of counterparty risk are monitored regularly, including bank credit ratings and concentrations which are monitored at the Investment Committee.

The principal area of counterparty risk is our use of inter-company quota share reinsurance as a capital management tool.

(h) Regulatory Risk

This risk is affected by changes in law and regulations which are not identified, understood, or are inappropriately and incorrectly interpreted, or adopted, or business practices are not efficiently modified. Further, there is a risk that current legal or regulatory requirements are not complied with. We have a constructive and open relationship with our regulators and Arch UK devotes considerable resources to meet its regulatory obligations, including compliance, risk management and internal audit functions.

(i) Conduct Risk

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

(j) Reputational Risk

Reputational risk is the risk of negative publicity as a result of the Company's contractual arrangements, customers, products, services and other activities. Key sources of reputational risk include reliance upon the Arch brand in the United States and Europe. The company is very protective of its brand and makes every effort to ensure it has the resources and expertise to be able to deliver an excellent service to its clients thus minimising the exposure to reputational risk. Where it is not possible or beneficial to avoid them, we seek to minimise their frequency and severity through public relations and communication channels.

(k) Capital Risk

The Company is regulated by the PRA and is subject to insurance solvency regulations which specify the minimum amount and type of capital that must be held in addition to the insurance liabilities.

The Company is subject to the Solvency II regime and is required to meet a Solvency Capital Requirement (SCR) which is calibrated to seek to ensure a 99.5% confidence of the ability to meet its obligations over a 12-month time horizon. The Company calculates its SCR in accordance with the standard formula prescribed in the Solvency II regulations, as the assumptions underlying the Standard Formula are considered to be a good fit for the Company's risk profile.

Although the Company uses the Standard Formula for determining its regulatory capital, it does have an Internal Capital Model that it uses for setting economic capital along with a number of other uses. In particular, as part of the acquisition of UK regional business, additional metrics are being regularly monitored under an "adjusted net asset basis", as if the company had acquired the UK Regional business directly, to ensure that the solvency position is adequate taking into account the company's current capital structure. The Company follows a risk-based approach to determine the amount of capital required to support its activities. Recognised stochastic modelling techniques are used to measure risk exposures, and capital to support business activities is allocated according to risk profile. Stress and scenario analysis is regularly performed, and the results are documented and reconciled to the Board's risk appetite where necessary.

Notes to the Financial Statements *(continued)*

4 Management of Risk *(continued)*

(k) Capital Risk *(continued)*

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

5 Critical accounting judgements and estimation uncertainty

The preparation of the financial statements in conformity with FRS 102, requires management to make judgements, estimates and assumptions that affect the application of accounting policies and reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

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

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

(i) *Key sources of estimation uncertainty*

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

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

(ii) *Process used to determine the assumptions for measuring insurance contracts*

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

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

Notes to the Financial Statements *(continued)*

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

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

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

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

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

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

(iii) *Valuation of investments in subsidiary*

At each reporting date, the Directors assess whether there is any indication that its subsidiary investment is impaired. Evidence considered can include a reduction in the net assets value of the subsidiary or changes to the trading outlook of the subsidiary. If such evidence of potential impairment exists then a revised fair value, and the value in use of the subsidiary is determined.

Notes to the Financial Statements (continued)

6 Segmental Information

Segmental information required under the Companies Act 2006 is as follows:

2019	Gross Premiums Written 2019 £000	Gross Premiums Earned 2019 £000	Gross Claims Incurred 2019 £000	Gross Operating Expenses 2019 £000	Reinsurance Balance 2019 £000	Total 2019 £000
Direct Insurance						
Accident and health	20,048	19,691	(9,610)	(7,557)	(3,245)	(721)
Marine, aviation and transport	16,644	10,029	(4,469)	(3,920)	(450)	1,190
Fire and other damage to property	130,123	99,573	(44,966)	(42,790)	(18,491)	(6,674)
Third party liability	129,183	111,559	(80,448)	(45,949)	8,038	(6,800)
Direct Total	**295,998**	**240,852**	**(139,493)**	**(100,216)**	**(14,148)**	**(13,005)**
Reinsurance Acceptance						
Accident and health	71	94	(235)	29	497	385
Reinsurance Acceptance Total	**71**	**94**	**(235)**	**29**	**497**	**385**
Total	**296,069**	**240,946**	**(139,728)**	**(100,187)**	**(13,651)**	**(12,620)**

2018	Gross Premiums Written 2018 £000	Gross Premiums Earned 2018 £000	Gross Claims Incurred 2018 £000	Gross Operating Expenses 2018 £000	Reinsurance Balance 2018 £000	Total 2018 £000
Direct Insurance						
Accident and health	12,617	16,078	(10,658)	(6,346)	57	(869)
Marine, aviation and transport	4,639	3,935	(1,248)	(1,161)	(1,488)	38
Fire and other damage to property	62,789	58,072	(29,336)	(20,799)	(11,394)	(3,457)
Third party liability	94,435	83,639	(52,304)	(33,606)	(2,104)	(4,375)
Direct Total	**174,480**	**161,724**	**(93,546)**	**(61,912)**	**(14,929)**	**(8,663)**
Reinsurance Acceptance						
Accident and health	342	29	(531)	5	220	(277)
Reinsurance Acceptance Total	**342**	**29**	**(531)**	**5**	**220**	**(277)**
Total	**174,822**	**161,753**	**(94,077)**	**(61,907)**	**(14,709)**	**(8,940)**

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

7 Net Operating Expenses

	2019 £000	2018 £000
Acquisition costs	(94,685)	(50,512)
Change in deferred acquisition costs	(2,772)	(82)
Administrative expenses	(19,905)	(14,358)
Reinsurance commissions and profit participation	91,394	52,748
	(25,968)	**(12,204)**

Notes to the Financial Statements *(continued)*

7 Net Operating Expenses *(continued)*

Administrative expenses include:

	2019 £000	2018 £000
Fees payable to the Company's auditors and their associates for the audit of the Company's annual accounts	(210)	(135)
Fees payable to the Company's auditors and their associates for the audit of subsidiaries	(51)	(37)
Fees payable to the Company's auditors and their associates for audit services pursuant to regulation	(68)	(74)
Fees payable to the Company's auditors and their associates for other services:	(7)	(13)
Total	**(336)**	**(259)**

8 Investment Income

	2019 £000	2018 £000
From investments designated as at fair value through profit or loss	1,102	585
Dividend received from subsidiary	-	6,000
Net gains / (losses) on realisation of investments	221	(102)
Unrealised gains / (losses) on investments	233	(224)
Total investment income	**1,556**	**6,259**

9 Directors' Emoluments and Employee Costs

The Company has no employees and instead entered into a secondment and service agreement with Arch Europe Insurance Services Ltd ("AEIS") in 2009, whereby services in the form of staff and facilities are provided to the Company. The Company is recharged staff costs from AEIS in accordance with the time allocations of the staff. In 2019 the Company was recharged £23.1 million (2018: £8.5 million) in relation to services provided by AEIS staff.

Directors' emoluments disclosed below relate to the amount of remuneration received by AIUK's Directors in respect of their qualifying services to the Company.

(a) Directors' Emoluments

	2019 £000	2018 £000
Directors' Emoluments		
Aggregate emoluments	1,012	1,604
Company pension contributions to money purchase schemes	18	19
Compensation to Directors for loss of office	-	-
Highest paid Director (included above)		
Aggregate of emoluments and awards under long-term incentive schemes	340	794
Directors' pension contributions	-	-
Number of Directors who received shares in ACGL	4	4
Number of Directors participating in money purchase scheme	3	2

There are no Key Management Personnel other than the Directors above.

Notes to the Financial Statements *(continued)*

(b) Employee Costs

The average number of staff employed by AEIS, but working for the Company during the year, analysed by category is as follows:

	2019	2018
Underwriting	260	28
Administration and finance	76	36
Claims	15	9
Total	**351**	**73**

	2019 £000	2018 £000
Salaries	19,213	7,163
Social security costs	2,181	763
Other pension costs	1,704	572
	23,098	**8,498**

The above employee costs include directors' costs.

10 Tax on loss

Tax (credit) / charge included in profit or loss

	2019 £000	2018 £000
Current tax:		
- UK corporation tax on loss for the year	-	-
- Adjustments in respect of prior years	(97)	-
Net UK corporation tax	(97)	-
- Foreign tax	1	1,811
Total current tax (credit) / charge	(96)	1,811
Deferred tax (Note 15):		
- Origination and reversal of timing differences	-	3,009
- Adjustments in respect of prior years	-	316
- Impact of change in tax rate	-	(5)
Total deferred tax charge	-	3,320
Tax on loss on ordinary activities	**(96)**	**5,131**

Notes to the Financial Statements *(continued)*

10 Tax on loss *(continued)*

Reconciliation of tax charge

The tax (income) / expense for the year is lower (2018: higher) than the standard rate of corporation tax in the United Kingdom for the year ended 31 December 2019 of 19.00% (2018: 19.00 %).

The differences are explained below:

	2019 £000	2018 £000
Loss on ordinary activities before tax	(10,559)	(2,838)
Loss on ordinary activities before tax multiplied by the standard rate of tax in the UK of 19.00% (2018: 19.00 %)	(2,007)	(539)
Effects of:		
- Expenses not deductible for tax purposes	55	111
- Income not subject to tax	-	(1,140)
- Deferred tax not recognised	1,952	4,931
- Expected reversal of timing differences at different tax rates	-	(354)
Foreign taxes	1	1,811
Remeasurement of deferred tax – change in the UK tax rate	-	(5)
Adjustments in respect of prior years	(97)	316
Total tax (credit) / charge for the year	**(96)**	**5,131**

Tax rate changes

The UK corporation tax rate applicable for the year was 19% (2018: 19%).

Changes to UK corporation tax rates were enacted on 15 September 2016 as part of Finance Act 2016. These changes include a reduction in the main rate of tax, which will reduce from 19% to 17% with effect from 1 April 2020.

Deferred taxes at the balance sheet date have been measured using these enacted tax rates and reflected in these financial statements.

11 Other Assets

	2019 £000	2018 £000
Claims Funds	11,522	7,542
Prepayments	6,030	1,114
	17,552	**8,656**

Notes to the Financial Statements *(continued)*

12 Investments in Subsidiary

The Company has an investment in a subsidiary company, Arch Europe Insurance Services Ltd, a company incorporated in the United Kingdom. AEIS provides services in the form of staff and facilities to the Company and other Arch UK companies. The cost of the investment was £5 million.

On 1 January 2019, the company made a further investment of £25.5m in AEIS.

Investments in Subsidiary	**Shares in Subsidiary £000**
At 1 January 2018	5,000
At 31 December 2018	5,000
At 1 January 2019	5,000
Investment in AEIS	25,500
At 31 December 2019	**30,500**

	Class of share held	**Percentage of nominal value and voting rights held by the Company**
Arch Europe Insurance Services Ltd	Ordinary	100

The registered office of AEIS is: 5th Floor, Plantation Place South, 60 Great Tower Street, London, EC3R 5AZ.

13 Accruals and Deferred Income

	2019 £000	**2018 £000**
Deferred ceding commissions	41,710	25,659
	41,710	**25,659**

14 Financial Investments

	Fair Value 2019 £000	**Cost 2019 £000**	**Fair Value 2018 £000**	**Cost 2018 £000**
Shares and other variable-yield securities				
Short term & cash equivalents	3,172	3,173	2,743	2,762
Other investments	1,338	1,337	1,907	1,913
	4,510	**4,510**	**4,650**	**4,675**

Notes to the Financial Statements *(continued)*

14 Financial Investments *(continued)*

	Fair Value 2019 £000	Cost 2019 £000	Fair Value 2018 £000	Cost 2018 £000
Debt securities and other fixed-income securities				
Sovereign & government agency	45,075	45,585	28,482	28,668
Corporate bonds	24,102	24,098	14,880	15,061
Other investments	-	-	24	24
	69,177	**69,683**	**43,386**	**43,753**

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

As at 31 December 2019

	Level 1 £000	Level 2 £000	Level 3 £000
Other variable-yield securities	3,172	1,338	-
Debt securities and other fixed-income securities	9,682	59,495	-
	12,854	**60,833**	**-**

As at 31 December 2018

	Level 1 £000	Level 2 £000	Level 3 £000
Other variable-yield securities	2,743	1,907	-
Debt securities and other fixed-income securities	7,441	35,921	24
	10,184	**37,828**	**24**

All of the other liabilities are expected to be settled no more than twelve months after the balance sheet date.

The movement in the year in level 3 is shown below:

As at 31 December 2019

	Level 3 £000
Balance brought forward	24
Change in value	-
Purchases	-
Sales	(24)
Balance carried forward	-

Notes to the Financial Statements *(continued)*

15 Deferred Tax

Deferred tax consists of the following recognised deferred tax assets / (liabilities):

	2019 Deferred tax assets £000	2019 Deferred tax liabilities £000	2019 Net deferred tax £000	2018 Deferred tax assets £000	2018 Deferred tax liabilities £000	2018 Net deferred tax £000
Trading losses	-	-	-	-	-	-
Claims equalisation reserves	-	-	-	-	-	-
Unrelieved foreign tax	-	-	-	-	-	-
	-	-	-	-	-	-

The movement in deferred tax assets and liabilities during the year is as follows:

	2019 Deferred tax assets £000	2019 Deferred tax liabilities £000	2019 Net deferred tax £000	2018 Deferred tax assets £000	2018 Deferred tax liabilities £000	2018 Net deferred tax £000
Deferred tax at 1 January	-	-	-	3,404	(84)	3,320
Credited / (charged) to the profit and loss account:						
Current year:						
- Trading losses	-	-	-	(3,088)	-	(3,088)
- Claims equalisation reserves	-	-	-	-	79	79
- Unrelieved foreign tax	-	-	-	-	-	-
Adjustments re prior years	-	-	-	(316)	-	(316)
Impact of tax rate change	-	-	-	-	5	5
	-	-	-			
	-	-	-	(3,404)	84	(3,320)
Deferred tax at 31 December	-	-	-	-	-	-

In prior years, deferred tax assets were recognised for carried-forward trading losses to the extent that the Directors considered it probable that future taxable profits would be available against which the losses would be offset and the related tax benefit would therefore be realised. These losses have arisen as the result of a number of natural catastrophes occurring to which the Company was exposed. Management now considers that the UK group's projected profits over the course of the next few years will probably not be sufficient to utilise these trading losses in full, and is taking the prudent approach of not recognising the associated deferred tax assets totalling £6,146k (2018: £4,412k).

A deferred tax asset of £56k (2018: £56k) has also not been recognised in respect of unrelieved foreign taxes paid. This is because it is considered probable that insufficient taxable profits will be available in the foreseeable future against which the tax credits can be utilised.

Should evidence arise in future accounting periods, such as sufficient actual or projected profits, the unrecognised deferred tax assets will be recognised.

Notes to the Financial Statements *(continued)*

16 Technical Provisions

(a) Summary of net technical provisions:

The following is a summary of the insurance contract provisions and related reinsurance assets as at 31 December.

	2019 Gross £000	2019 Ceded £000	2019 Net £000	2018 Gross £000	2018 Ceded £000	2018 Net £000
Notified claims	241,981	(220,787)	21,194	247,111	(228,103)	19,008
IBNR	264,997	(239,878)	25,119	251,364	(227,565)	23,799
Unearned Premium	131,983	(118,860)	13,123	79,811	(74,672)	5,139
	638,961	**(579,525)**	**59,436**	**578,286**	**(530,340)**	**47,946**

Reconciliation of claims technical provisions

(b) Reconciliation of claims technical provisions

	2019 £000	2018 £000
Net claims technical provisions brought forward		
Outstanding claims	19,008	7,798
IBNR claims	23,799	31,912
	42,807	39,710
Losses incurred in the year		
Current accident year	13,397	12,634
Prior accident years	(1,035)	(1,557)
	12,362	11,077
Paid losses		
Current accident year	(1,526)	(643)
Prior accident years	(6,326)	(7,717)
	(7,852)	(8,360)
Foreign exchange differences	(5,628)	(6,497)
Claims payable timing delay	4,624	6,877
Net claims technical provisions carried forward		
Outstanding claims	21,194	19,008
IBNR claims	25,119	23,799
	46,313	**42,807**

Notes to the Financial Statements *(continued)*

16 Technical Provisions *(continued)*

(c) Gross claims development triangles – by underwriting year

Underlying Pure Year	At end of underwriting year	One year later	Two years later	Three years later	Four years later	Five years later	Cumulative payments	Outstanding reserves
	£000	£000	£000	£000	£000	£000	£000	£000
2014	64,020	115,503	118,038	116,499	111,512	104,243	74,437	29,806
2015	47,821	106,510	118,542	117,949	114,381		66,189	48,192
2016	47,823	101,330	95,917	97,172			55,777	41,395
2017	58,711	115,263	119,896				37,767	82,129
2018	48,861	115,057					31,077	83,980
2019	44,467						1,819	42,648
Total	**311,703**	**553,663**	**452,393**	**331,620**	**225,893**	**104,243**	**267,066**	**328,150**
							2013 & Prior	178,828
							Total	**506,978**

(d) Net claims development triangles – by underwriting year

Underlying Pure Year	At end of underwriting year	One year later	Two years later	Three years later	Four years later	Five years later	Cumulative payments	Outstanding reserves
	£000	£000	£000	£000	£000	£000	£000	£000
2014	6,138	10,788	11,234	10,991	10,347	9,541	7,177	2,364
2015	4,269	8,839	9,724	9,978	9,923		6,456	3,467
2016	4,488	9,393	9,229	9,519			5,968	3,551
2017	4,983	10,185	10,795				4,188	6,607
2018	4,185	11,338					3,506	7,832
2019	4,304						250	4,054
Total	28,367	50,543	40,982	30,488	20,270	9,541	27,545	27,875
							2013 & Prior	18,438
							Total	**46,313**

The movement in prior year's provision for net claims outstanding was a reduction of £6.4 million.

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

Claims Provisions

	2019 Gross £000	2019 Ceded £000	2019 Net £000	2018 Gross £000	2018 Ceded £000	2018 Net £000
At 1 January	498,475	(455,668)	42,807	497,725	(458,015)	39,710
Movement per technical account	26,658	(22,148)	4,510	(9,726)	12,443	2,717
Exchange Rate Impact	(22,779)	17,151	(5,628)	3,599	(10,096)	(6,497)
Claims payable timing delay	4,624	-	4,624	6,877	-	6,877
31 December	**506,978**	**(460,665)**	**46,313**	**498,475**	**(455,668)**	**42,807**

Notes to the Financial Statements *(continued)*

16 Technical Provisions *(continued)*

Unearned Premiums

	2019 Gross £000	2019 Ceded £000	2019 Net £000	2018 Gross £000	2018 Ceded £000	2018 Net £000
At 1 January	79,811	(74,672)	5,139	65,260	(60,524)	4,736
Movement per technical account	55,123	(46,915)	8,208	13,069	(12,094)	975
Exchange Rate Impact	(2,951)	2,727	(224)	1,482	(2,054)	(572)
31 December	**131,983**	**(118,860)**	**13,123**	**79,811**	**(74,672)**	**5,139**

17 Called Up Share Capital

Ordinary shares	**2019 £000**	**2018 £000**
Authorised:		
10 million (2018: 10 million) ordinary shares of £10 each	100,000	100,000
Issued and fully paid up:		
5 million (2018: 5 million) ordinary shares of £10 each	50,000	50,000

18 Other Reserves

In 2019, the Company received £10 million capital contribution from its parent company to support the new business generated as a result of the UK Regional acquisition, bringing the total other reserves to £42.5 million.

19 Guarantees and Financial Commitments

The Company has outstanding letters of credit of £56,614 (2018: £58,888) issued in favour of cedants, collateralised by cash deposits, with a market value of £66,027 (2018: £141,698) held in trust.

In 2019, the Company received an £8 million loan from Arch Capital Finance Ireland, a group company, to support growth from the new UK Regional business.

20 Contingencies

Like most other insurers, the Company may from time to time be involved in legal proceedings, claims and litigation in the normal course of business. The Company does not believe that such actions will have a material effect on its profit or loss and financial condition.

21 Controlling Parties

The immediate parent undertaking is Arch Reinsurance Europe Underwriting Designated Activity Company ("Arch Re Europe"), a company incorporated in Ireland.

The ultimate parent undertaking and controlling party is Arch Capital Group Ltd., a company incorporated in Bermuda.

Notes to the Financial Statements *(continued)*

21 Controlling Parties *(continued)*

Arch Capital Group Ltd is also the parent undertaking of the smallest and largest group of undertakings for which group financial statements are drawn up and of which the Company is a member.

Copies of the consolidated financial statements of Arch Capital Group Ltd can be obtained from The Secretary, Arch Capital Group Ltd., Waterloo House, Ground Floor, 100 Pitts Bay Road, Pembroke HM 08, Bermuda.

22 Related Parties

Key management personnel and director transactions

There were no transactions between the Company and its Directors during the year ended 31 December 2019 (2018: nil) which require disclosure.

23 Post Balance Sheet Events

The World Health Organisation declared a pandemic in relation to the Novel Coronavirus (COVID-19) on 11 March 2020. The outbreak is causing unprecedented social disruption, and global economic and financial markets volatility.

As the emergence of the situation is in its earlier stages, the full extent of exposures to and impacts on the Company are uncertain and therefore the financial impacts cannot be reliably estimated at this point in time. The pandemic is considered a non-adjusting event and therefore no allowance for losses or other financial impacts has been made in the financial statements. Further information related the potential impact of COVID-19 on the Company can be found in the Strategic report on page 11.

Directors and Administration

Directors as at 20 March 2020

S. Bashford	Chief Underwriting Officer
N. Denniston	Non-Executive and Chairman
J. Kittinger	Finance Director
P. Leoni	Chief Underwriting Officer
P. Martin	Non-Executive
J. Mentz	Director
P. Storey	Non-Executive
H. Sturgess	President and Chief Executive Officer

Company Secretary

TMF Corporate Administration Services Limited

Registered Number

04977362

Registered Office

5th Floor
Plantation Place South
60 Great Tower Street
London
EC3R 5AZ

Principal Bankers

Barclays Bank Plc, London

Investment Manager

BlackRock Inc., New York

Independent Auditors

PricewaterhouseCoopers LLP,
Chartered Accountants and Statutory Auditors
7 More London Riverside
London, SE1 2RT

Financial Strength Ratings

A.M. Best rating: A+ (Superior)
Standard & Poor's rating: A+ (Strong)

Website

www.archinsurance.co.uk