



Arch Insurance (UK) Limited  
Solvency and Financial Condition Report  
31 December 2020

Arch Insurance (UK) Limited  
8 April 2021

# SOLVENCY AND FINANCIAL CONDITION REPORT

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## SUMMARY

Arch Insurance (UK) Limited (“AIUK” or “the Company”) sets out in this report the solvency and financial condition of the Company as at 31 December 2020, as required by Solvency II Regulations and the Solvency II Directive (as implemented in the UK in the Prudential Regulation Authority (PRA) rulebook for Solvency II firms). The purpose of the Solvency and Financial Condition Report (“SFCR”) is to provide stakeholders with additional information over and above that contained in the annual financial statements, which are available from Companies House.

This SFCR for AIUK is for the year ended 31 December 2020 and all amounts are presented in thousands of Sterling (£’000).

The SFCR contains qualitative and quantitative information on AIUK business and performance, its system of governance, risk profile, valuation for solvency purposes and capital management.

AIUK is a UK authorised insurer and part of the Arch Group of companies. AIUK is a wholly owned subsidiary of Arch Reinsurance Europe Underwriting Designated Activity Company (“ARE”), an Ireland-based company. The ultimate parent company of AIUK is Arch Capital Group Ltd. (“ACGL” or together with its subsidiaries, “ACGL Group” or the “Group”), a Bermuda public limited liability company with \$15.8 billion (2019: \$13.2 billion) of shareholder capital as at 31 December 2020. 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 principal activity of the Company is to underwrite Energy, Property and Casualty insurance business, including but not limited to, Specialty lines of insurance. The Company operates from its head office in London and its UK regional offices. We classify our business into the following Solvency II lines of business: Medical Expense, Income Protection, Motor Vehicle Liability, Other Motor, General Liability, Credit and Suretyship, Marine, Aviation and Transport, Fire and other damage to Property insurance.

### Business, Strategy and Performance

Our insurance underwriting strategy is to operate in 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 appropriate pricing across the underwriting cycle. To achieve this, we encourage adherence to uniform underwriting standards across each product line focusing on: risk selection; desired

attachment point; limits and retention management; due diligence, including financial condition, claims history, management and exposure; underwriting authority and approval limits; and collaborative decision-making.

The rating environment improved significantly during 2020, with firmer pricing for many lines of business including Property, Casualty and Energy whilst simultaneously the Novel Coronavirus (COVID-19) pandemic continued to develop, creating increased uncertainty in the markets. The Company's gross exposure to the COVID-19 pandemic was £43.8 million, mainly driven by business interruption policies on the Company's regional book of business. As a result of the extensive reinsurance program, the net exposure was limited to £3.2 million.

Following the outcome of the FCA's Business Interruption Test Case, of which the Company was a part, management have reviewed the Company's COVID-19 reserves and considered them to be an accurate reflection of the Company's exposure with no material additional provisions arising from the outcome of the test case.

Reflecting the strengthened rating environment, the Company's underwriting strategy for 2020 was more offensive, actively seeking out new business and maximising the opportunities for growth. Notwithstanding the competitive environment, the Company has sought to maintain its underwriting discipline and execute its philosophy on superior risk selection.

The focus for 2020 has been the continued growth through expansion of profitable lines of business and the capital of the Company and Group remains available to support this. 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.

### System of Governance

There are no material changes in the Company's systems of governance during the year. The Company maintains an effective system of governance, which provides for sound and prudent management of its integrated operations.

The Company has designed its system of governance to achieve the following:

- Maintain an adequately transparent organisational structure that has well-defined, clear, consistent and documented lines of responsibility across the integrated operations;
- Ensure staff have the skills, knowledge and expertise necessary to properly discharge their assigned responsibilities;
- Establish and maintain processes to achieve effective internal reporting and communication of information at all relevant levels within the integrated operations;
- Maintain information systems that produce sufficient, reliable, consistent, timely and relevant information concerning all business activities, the commitments assumed and the risks to which the integrated operations are exposed;
- Safeguard the security, integrity and confidentiality of information, taking into account the nature of the information in question; and
- Ensure outsourced responsibilities are delegated and managed appropriately, with ultimate responsibility residing with the Board.

The system of governance is based on the principle of proportionality, such that systems and controls are proportionate to the nature, scale and complexity of the integrated operations. Appropriate and proportionate systems, resources and procedures are in place for the Company's operations.

In this regard, the Board monitors key aspects of the business and is assisted where appropriate by the approved committees operating under the agreed set of terms of reference for each of the committees.

The principles and requirements of the system of governance, particularly risk management, internal control, compliance, internal audit, actuarial and outsourcing, are the responsibility of the Board. The Board Risk Committee oversees the Risk Management Framework for operating effectiveness and reports to the Board as appropriate.

The Board has approved formal policies, which are a component of the Company's Governance Structure.

The system of governance is assessed via reviews by the Legal, Regulatory and Compliance Team, and all related findings and/or reports are presented to the Board.

### **Risk Profile**

The Company's risk appetite framework provides an expression of the level of risk it is willing to accept in pursuit of its strategic objectives. The risk appetite framework provides quantitative and qualitative statements which are used to define the general attitude within the organisation towards the desired level of risk. It not only supports the Risk Management Framework; it also enables the Company to make informed business decisions having regard to the key risks to which it may be exposed by such a decision.

In general, the Company has an appetite for insurance (underwriting) risk and a tolerance for other forms of risk. The risk philosophy of the Company encompasses all major risks and focuses on attaining the following business objectives:

- Underwrite business that meets agreed targeted returns;
- Underwrite business with selected insureds;
- Underwrite only carefully selected business lines;
- Manage underwriting volumes in line with the business cycle; and
- Limit the downside risk such that the Company maintains a sufficient solvency margin.

To meet these objectives and the Company's overall strategy, metrics for the performance against risk appetites and risk tolerances & limits, as articulated in the Company's Risk Appetite Statement, are monitored by the Risk Management function and reported on to the Risk Committee on a quarterly basis with a defined escalation process where breaches occur.

### **Valuation for Solvency II Purposes**

The Company's Solvency II balance sheet is prepared on an economic or fair value basis. The most significant differences between the Solvency II balance sheet and that on a FRS 102 (UK GAAP) basis arise from;

- the valuation of technical provisions and reinsurer's share of technical provisions including the removal of an implicit margin of prudence;
- the valuation of holdings in related undertakings; and
- the valuation of deferred acquisition costs and deferred ceding commission.

No volatility or matching adjustments are included and therefore no transitional measures are used.

## Capital Management

The Company has adopted a capital management policy and plan setting out the methodology and procedures to provide oversight of the Company's own funds and compliance with regulatory capital requirements.

The Company's own funds are summarised in the table below:

	Tier 1	Tier 2	Tier 3	2020 Total Own Funds	2020 Adjusted net asset Approach *	2019 Total Own Funds	2019 Adjusted net asset Approach *
	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Paid-In Ordinary Share Capital	50,000	-	-	50,000	50,000	50,000	50,000
Other capital contribution	57,500	-	-	57,500	26,500	42,500	12,500
Reconciliation Reserve	(15,571)	-	-	(15,571)	(15,571)	(16,782)	(16,782)
Subordinated liabilities	-	15,500	-	15,500	15,500	8,000	8,000
<b>Total Own Funds After Deductions</b>	<b>91,929</b>	<b>15,500</b>	<b>-</b>	<b>107,429</b>	<b>76,429</b>	<b>83,718</b>	<b>53,718</b>
Total Eligible Own Funds to Meet the SCR				107,429	76,429	83,718	53,718
Total Eligible Own Funds to Meet the MCR				94,127	60,929	78,058	48,058
SCR				38,353	34,372	46,792	43,759
MCR				10,993	10,993	11,698	10,940
<b>Ratio of Eligible Own Funds to SCR</b>				<b>280.1%</b>	<b>222.4%</b>	<b>178.9%</b>	<b>122.8%</b>
<b>Ratio of Eligible Own Funds to MCR</b>				<b>856.2%</b>	<b>554.2%</b>	<b>667.3%</b>	<b>439.3%</b>

\* The "adjusted net asset basis" is reviewed as part of the Company's internal governance processes, but is not independently audited.

The Own funds consist of Tier 1 capital made up of £50.0 million issued and fully paid up ordinary shares, £57.5 million other capital contribution, a loss of £15.6 million in the reconciliation reserve and Tier 2 subordinated loans of £15.5 million.

The Company had an existing capital contribution of £42.5 million and in 2020 the Company received £15.0 million capital contribution from its parent company, ARE, to support the business due to reserve implication arising out of the COVID-19 pandemic, bringing the total contributions to £57.5 million. This capital is offset by a loss of £15.6 million in the reconciliation reserve under Solvency II. In 2020 the Company received an additional loan of £7.5 million from Arch Capital Finance (Ireland) Limited ("ACFI"), a group company, to support growth from the new UK Regional business. This loan was included in the Tier 2 capital which totals £15.5 million. This loan meets the required PRA guidelines to classify as a subordinated loan. AIUK has no Tier 3 capital at 31 December 2020.

The Company uses the Standard Formula for determining its regulatory capital and follows a risk-based approach to determine the amount of capital required to support its activities. Following the acquisition of the UK regional business, an "adjusted net asset basis" was introduced and reported internally to manage the Company's solvency position, taking into account the Company's current capital structure. The "adjusted net asset basis" is an additional, internally applied, more prudent

measure, that the Board uses to monitor solvency, and is not part of the requirement of Solvency II. It is reviewed as part of the Company's internal governance processes, but is unaudited.

Under the "adjusted net asset basis", the Company's own funds available is £76.4 million as at December 2020 against the SCR of £34.4 million, with a surplus of £42.0 million or 222.4%. The "adjusted net asset basis" excludes the loan balance with Arch Intermediaries Group Limited ("AIGL"), formerly known as Arch (UK) Holdings Limited, within the available own funds and the SCR excludes the equity invested as part of UK Regional acquisition.

### **Brexit and Part VII Transfer**

Following the decision of the UK electoral vote in favour of leaving the EU, the parties agreed to a trade deal on 24 December 2020, which does not currently cover financial services. In particular, the trade deal does not provide passporting rights similar to those which exist in the EU single market, meaning a UK firm doing business with EU clients will need to be authorised in an EU member state, rely on exclusions, or rely on temporary relief.

To ensure the Group can continue to service its EU clients, Arch Insurance (EU) dac ("AIEU"), a company domiciled in Ireland and authorised by the Irish regulator, the Central Bank of Ireland (CBI) was set up in 2019 and has been able to provide cover on and from 29 March 2019 for new EEA policies written.

On 18 December 2020, the High Court of Justice of England and Wales approved the Part VII Transfer of the EEA policies (excluding inwards reinsurance) of the Company, written between 26 November 2003 and 31 December 2020, to AIEU.

The transfer of premiums and claims has been reflected in both the Balance Sheet and the corresponding accounts on the Profit and Loss Account. The value of net assets to be passed to AIEU as part of the Part VII transfer were calculated on a Solvency II basis, rather than a UK GAAP basis. As a result, the value of the assets transferred exceeded the UK GAAP liabilities by £0.1m, leading to a loss to the Company. The loss has been recognised within the "other expense" line in the Profit and Loss Account.

The following business has been transferred to AIEU under the Scheme:

- All policies forming part of the portfolio of general insurance policies of AIUK carried out prior to the Effective Date where the risk associated with such policy is located in an EEA State other than the UK (the "Transferring Portfolio");
- the outwards reinsurance policies issued to AIUK where these are relevant to or provide protection for a policy referred to in the previous bullet point;
- contracts and other commitments to which AIUK is a party at the transfer date and which relate to the policies or reinsurance policies referred to above (this will include the coverholder arrangements currently in place in the various EEA States other than the UK in which risks are located); and
- the assets and liabilities (excluding mis-selling liabilities) relating to each of the above.

The Scheme excludes the following AIUK policies and this business has not been transferred to AIEU ("the Remaining Portfolio"):

- All policies forming part of the portfolio of general insurance policies of AIUK carried out prior to the Effective Date where the risk associated with such policy is not located in an EEA State other than the UK; and
- All inwards reinsurance policies.



The table below shows the impact of the Part VII transfer to the Solvency II balance sheet:

Balance Sheet as at 31 December 2020 - £'000s	Pre Part VII - Solvency II	Impact of Part VII - Solvency II	Post Part VII - Solvency II
Deferred acquisition costs	-	-	-
Holdings in related undertakings, including	38,087	-	38,087
Equities - unlisted	-	-	-
Government Bonds	52,459	(16,750)	35,709
Corporate Bonds	20,497	-	20,497
Collateralised securities	1,627	-	1,627
Collective Investments Undertakings	19,288	-	19,288
Reinsurance recoverables from: Non-life and	496,231	(132,009)	364,222
Insurance and intermediaries receivables	16,411	(5,881)	10,530
Reinsurance receivables	29,723	(16,592)	13,131
Receivables (trade, not insurance)	40,314	-	40,314
Cash and cash equivalents	12,401	-	12,401
Any other assets, not elsewhere shown	(17,245)	31,433	14,188
<b>Total assets</b>	<b>709,793</b>	<b>(139,799)</b>	<b>569,994</b>
Technical provisions - non-life	575,955	(144,499)	431,456
Reinsurance payables	-	-	-
Payables (trade, not insurance)	12,300	-	12,300
Subordinated liabilities	15,500	-	15,500
Any other liabilities, not elsewhere shown	14,109	4,700	18,809
<b>Total liabilities</b>	<b>617,864</b>	<b>(139,799)</b>	<b>478,065</b>
<b>Net Assets</b>	<b>91,929</b>	<b>-</b>	<b>91,929</b>

### COVID-19 pandemic

On 11 March 2020, the World Health Organization declared COVID-19 to be a pandemic as the number of countries with infections started to grow. Shortly afterwards, the Company implemented the Group Pandemic Plan in line with our Business Continuity Plans. All offices were closed worldwide with our employees working from home. The entire workforce was quickly up and running with remote working functionality, with additional equipment arranged where required.

During the initial lockdown period, the Risk and Control team performed a review in conjunction with the various business areas and sought to determine whether, and to what extent, business risks had changed due to the pandemic impacting the business. The review also considered whether the effectiveness of any controls could be compromised as a result of staff working from home. On the whole, it was found that although there was increased commercial risk to the business with potentially less business written due to homeworking conditions, operational risk had not materially increased and the overall business was able to function broadly as before the pandemic.

The Company's chief concern throughout has remained the safety of our employees and their families at this unprecedented time and continues to ensure both the wellbeing of staff and the ongoing operational requirements of the business are met. As well as practical initiatives to facilitate efficient working from home for all staff, a number of well-being initiatives have been launched during the last 12 months. This includes the Mental Health First Aider ("MHFA") team, who have provided support to all staff during the pandemic.

The Risk and Control team continues to monitor the impact on the business, there however remains significant uncertainty around the implications of the pandemic, with negative economic impact

anticipated, as well as the risk of further “waves” of infections within countries and communities. Whilst there have been no reports of significant infection rates amongst staff, infection rates continue to be monitored on an ongoing basis.

In addition, on 1 May 2020, the FCA announced that it would commence court proceedings against eight insurers (including the Company) in order to clarify key uncertainties in the wider market around the response of Business Interruption cover to the COVID-19 pandemic. Following initial rulings by the Court and High Court, on 15 January 2021 the Supreme Court delivered its judgement, substantially allowing the FCA’s appeal on behalf of policyholders.

Whilst the impact of this ruling on the insurance industry as a whole remains uncertain due to the diversity of policy wording within Business Interruption policies, the Company has reviewed its COVID-19 reserves against the latest ruling and has concluded that they are adequate. As the claims experience continues to develop, the reserves continue to be subject to ongoing review.

In addition to the reserve risk arising out of the COVID-19 pandemic, there is also an increased probability of further risks arising out of the pandemic in the future. These risks include second order impacts on the economy, the insurance industry and individual classes of business, such as interest rate and currency volatility, increased risk of security defaults and an increased risk of inability to bind business. As the Company continues to be closely currency matched, the exposure to currency volatility is significantly reduced, whilst the interest rate risk continues to be monitored in conjunction with the investment manager. To date, no increase in security defaults have been observed or notified by the investment manager but the investment committee continues to monitor the performance of the Company’s investment portfolio. Furthermore, the transition to working fully digitally has been successful with the ability to bind business not being adversely impacted by the COVID-19 pandemic.

The table below shows the impact of COVID-19 pandemic on the technical provisions at 31 December 2020.

	<b>Technical Provisions excluding COVID</b>	<b>Technical Provisions relating to COVID</b>	<b>Technical Provisions including COVID</b>
Gross Best Estimate including Risk Margin	387,686	43,770	431,456
Net Best Estimate including Risk Margin	64,048	3,186	67,234

### Directors’ Responsibilities

We acknowledge our responsibility for preparing the Solvency and Financial Condition Report (“SFCR”) in all material respects in accordance with the Prudential Regulatory Authority (“PRA”) Rules and the Solvency II Regulations.

We are satisfied that:

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

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

On behalf of the Board

A handwritten signature in black ink, appearing to be 'JK', with a long horizontal stroke extending to the right.

**Jason Kittinger**

*SVP, Chief Financial Officer*

8 April 2021

## SECTION A Business and Performance

### A.1 Business

#### A.1.1 Name and Legal Form of the Undertaking

Arch Insurance (UK) Limited is incorporated in the United Kingdom. The address of the registered office of the Company is:

60 Great Tower Street  
London  
EC3R 5AZ

This SFCR covers the Company on a solo basis.

#### A.1.2 Insurance Supervisors

##### Prudential Regulations Supervisor

Prudential Regulation Authority ("PRA")  
20 Moorgate  
London  
EC2R 6DA

##### Financial Conduct Supervisor

Financial Conduct Authority ("FCA")  
12 Endeavour Square  
London  
E20 1JN

##### Group Supervisor

Bermuda Monetary Authority ("BMA")  
BMA House  
43 Victoria Street  
Hamilton HM 12 Bermuda

#### A.1.3 External Auditor

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

#### A.1.4 Description of the ownership details including proportion of ownership interest

ARE, a company incorporated in Ireland, owns 100% of the equity share capital of the Company. The Company's ultimate parent and ultimate controlling party is ACGL.

#### A.1.5 Group Structure

As stated above, the Company's ultimate parent and ultimate controlling party is ACGL, a Bermuda public limited liability company. ACGL prepares group financial statements and is the largest Group for which group financial statements are drawn up and of which the Company is a member. Copies of the ACGL group financial statements are available on ACGL's website located at [www.archcapgroup.com](http://www.archcapgroup.com) or on the website of the U.S. Securities and Exchange Commission located at [www.sec.gov](http://www.sec.gov).

The smallest group of undertakings for which group financial statements are drawn up, and of which the Company is a member is Arch Reinsurance Limited ("ARL"), a Bermuda-based company.

Below is a summary view of the Company organisational chart and a complete organisation chart of ACGL and AIUK's position in the Group is included as **Appendix 1**, all entities in the simplified structure have 100% shareholding and voting rights.



### **A.1.6 Material related undertakings**

The Company owns 100% of Arch Europe Insurance Services Ltd. (“AEIS”), a company incorporated in United Kingdom. AEIS provides services in the form of staff and facilities to the Company.

### **A.1.7 Business review**

#### **Business Trends**

Despite the COVID-19 pandemic continuing to bring increased uncertainty in the insurance market, 2020 saw significant rate increases across a number of lines of business, allowing the Company to successfully grow its book of business.

The end of the 2020 financial year saw the successful implementation of the Company’s Brexit solution in the form of the Part VII transfer of the Company’s EEA non-life insurance policies written between 2003 and 2020 to AIEU, mitigating the regulatory risk arising out of Brexit. Going forward, the Company is well positioned to continue underwriting and servicing non EEA risks.

The focus for 2021 is to take advantage of the hardening market and the continued growth through expansion of profitable lines of business whilst maintaining strong underwriting discipline. It is anticipated that the economic climate will remain challenging following the impacts of the COVID-19 pandemic. However, the Company’s reinsurance program is expected to continue to limit the net COVID-19 exposure whilst the capital of both the Company and the Group remains available to support the Company’s growth plans.

#### **Climate change**

Throughout 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 and their ability to manage risks arising out of environmental and social changes.

The Company, as part of the wider ACGL group, is governed by the ESG Steering Committee, which is chaired by Marcy Rathman, who has responsibility for coordinating and managing the oversight of ACGL’s growing ESG program. The Directors of the Company review the output of the ESG Steering Committee, and where deemed appropriate incorporate its recommendation in their management of the Company.

In addition, the Directors have made an assessment of the specific risk of climate change to the Company and have identified potential risks relating to underwriting and investment risks, each of which has been set out in further detail below.

## Underwriting risks

The Company has a well-established exposure management framework, used to measure and manage catastrophe loss probability. The exposed policies are modelled by country and peril to estimate loss probabilities from natural catastrophe events, such as cyclones, windstorms, earthquakes, floods, bushfires and other hazards.

The whole portfolio is reassessed on a quarterly basis and the assessment includes modelling of historic events and probabilistic extremes of events across relevant geographic regions. Climate change signals, such as warming of sea surface temperatures are incorporated into the parameterisation of the model used.

The Company's models are tested for sensitivity and stress tested against the Company's historic claims experience. The key metric used is the 1 in 250 year stress test performed on a gross and net basis, which are tracked quarterly. A number of scenarios have been considered based on the PRA's 2020 General Insurance Stress Test climate change specifications, which show that there 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.

The Company, is looking at all aspects of the potential new underwriting environment that may emerge with the advent of various aspects of climate change. Both first and third party underwriters are working to continually assess the impact of various climate change scenarios on the existing and future portfolio, including but not limited to changing weather pattern and changing sea levels and their impact on risk selection and aggregation; to novel litigation against various companies or their directors and officers for their alleged fault in enabling such change, which may impact risk selection and policy structure; to the opportunities generated by a changing economy. The Company is a writer of renewable energy business, of companies developing and manufacturing electric vehicles and insurers of various projects and research which both enable and profit from a new economy; this develops as the opportunity itself develops and has in itself challenges around pricing and policy form, in which we invest our own intellectual property.

## Investment risk

The Company has an investment portfolio worth £77.1 million consisting mainly of shares, debt securities, fixed-income securities and other variable-yield securities. Investments are managed by Arch Investment Management Limited ("AIM"), a member of the wider ACGL Group.

The investment committee, which has been delegated oversight of the Company's investment portfolio by the Board of Directors is aware of the importance of stewardship and sustainability alongside integrating ESG into the overall governance structure, which involves the inclusion of Environmental, Social and Governance factors into wider investment analysis. At the ACGL level, ESG scores are incorporated into the overall portfolio analysis on a regular basis, the outcome of which is made available to the local investment committee.

The Company is fully cognisant of the emerging importance of climate change as a fundamental societal issue and is actively investigating opportunities in underwriting, investments and its operational organisation and supply chains to act responsibly and to support the trend towards a sustainable transition to the post-Carbon society.

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.

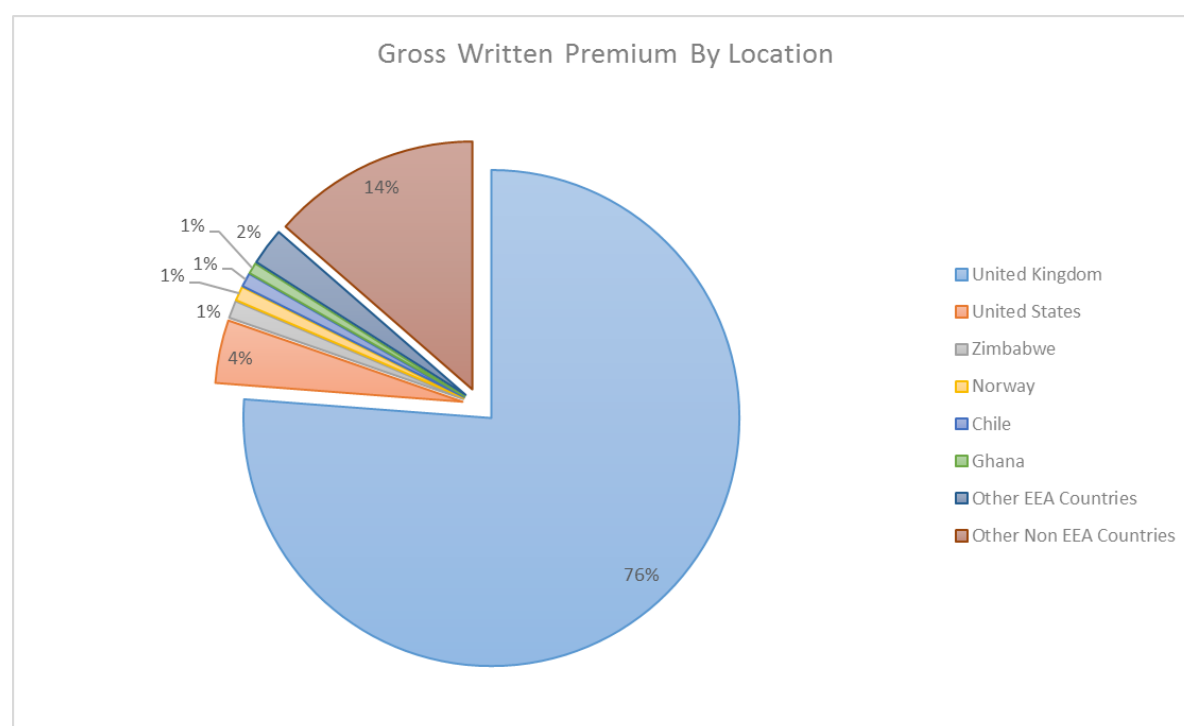
### Significant regulatory and legal matters

The Company is not currently subject to any significant regulatory intervention or legal litigation.

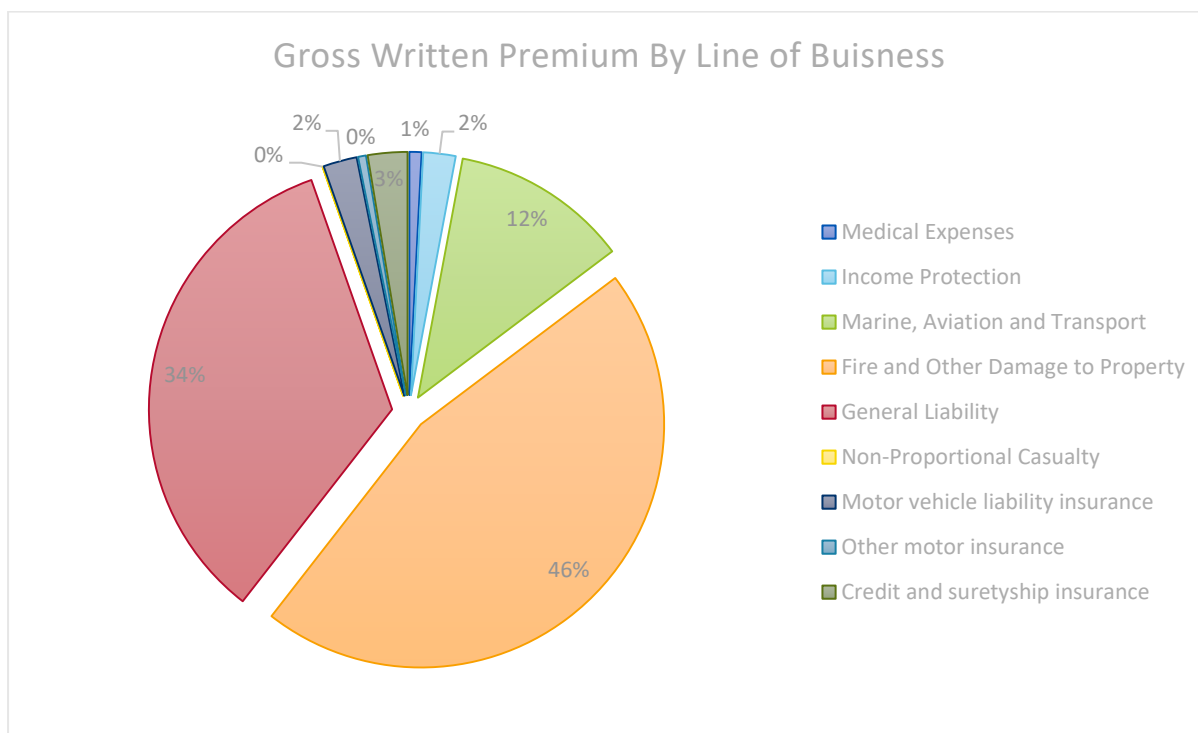
#### **A.1.8 Material Lines of Business and Geographical areas where business is conducted**

The principal activity of the Company is to underwrite Energy, Property and Casualty insurance business, including but not limited to, Specialty lines of insurance. The Company operates from its head office in London and its UK Regional offices.

The following diagram shows the total gross written premiums for each of the Company's lines of business and the location of the risk. The Company wrote £357.6m of gross written premium at the year ended 31 December 2020 (2019: £296.1 million).







#### **A.1.9 Significant Business or Other Events**

##### **Departure of the United Kingdom from the European Union ("Brexit")**

See Summary Section and Section A1.7

##### **COVID-19 pandemic**

See Summary Section and Section A1.7

##### **Change in Accounting Estimates**

Previously management applied methodology to estimate the last month of the year premium (i.e. December month premium) based on prior-year actual December premium. However under new estimation techniques, the December month premium will be estimated using an accrual based on actual information from the policy administration system. The change in estimate leads to a more accurate estimation of amounts. The cumulative impact of the change in estimate on premiums is material on a gross basis (with no material impact on retained earnings / equity either individually or cumulatively, given that the written premium in December is substantially unearned at the balance sheet date).

The tables below set out the impact of the change in estimate on the 2020 financials. The impacts disclosed are for the current period only and there will be no impact on future periods resulting from the initial change in estimate.

## Impact on the Profit and Loss Account for the year ending 31 December 2020

	<b>2020 £000</b>
<b>Earned premium, net of reinsurance</b>	
Gross premiums written	28,095
Outward reinsurance premiums	(24,410)
Net premiums written	<u>3,685</u>
Change in the gross provision for unearned premiums	(28,095)
Change in the provision for unearned premiums, reinsurers' share	24,410
Earned premiums, net of reinsurance	<u>-</u>
<b>Total technical income</b>	<u><u>-</u></u>
<b>ASSETS</b>	<b>2020 £000</b>
<b>Reinsurers' share of technical provisions</b>	
Provision for unearned premiums	<u>24,410</u>
<b>Debtors</b>	
Debtors arising out of direct insurance operations	<u>21,191</u>
<b>Prepayments and accrued income</b>	
Deferred acquisition costs	6,903
<b>TOTAL ASSETS</b>	<u><u>52,504</u></u>
<b>LIABILITIES</b>	
<b>Technical provisions</b>	
Provision for unearned premiums	<u>28,095</u>
<b>Creditors</b>	
Creditors arising out of reinsurance operations	<u>15,546</u>
<b>Accruals and deferred income</b>	8,863
<b>TOTAL LIABILITIES</b>	<u><u>52,504</u></u>

## A.2 Underwriting Performance

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 and 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").

The following table summarises the underwriting results for year ended 31 December 2020 and year ended 31 December 2019.

	2020	2020	2019	2019
	(excl. intra-group reinsurance)	(incl. intra-group reinsurance)	(excl. intra-group reinsurance)	(incl. intra-group reinsurance)
	£'000	£'000	£'000	£'000
Gross Premiums Written	357,553	357,553	296,069	296,069
Net Premiums Written	276,634	41,495	232,103	33,919
<b>Net Premiums Earned</b>	<b>251,513</b>	<b>37,727</b>	<b>176,870</b>	<b>25,710</b>
Net Claims Incurred	(165,876)	(24,881)	(105,171)	(12,363)
Net underwriting expenses	(105,690)	(21,438)	(84,930)	(25,968)
<b>Net underwriting results</b>	<b>(20,053)</b>	<b>(8,592)</b>	<b>(13,231)</b>	<b>(12,621)</b>
Investment return and foreign exchange	(344)	(344)	2,061	2,061
<b>Loss before taxation</b>	<b>(20,397)</b>	<b>(8,936)</b>	<b>(11,170)</b>	<b>(10,560)</b>
Taxation	-	(4)	96	96
<b>Loss for the year</b>	<b>(20,397)</b>	<b>(8,940)</b>	<b>(11,074)</b>	<b>(10,464)</b>
Claims ratio	66.0%	66.0%	59.5%	48.1%
Expense ratio	42.0%	56.8%	48.0%	101.0%
Combined ratio	108.0%	122.8%	107.5%	149.1%

*Note: The Directors of the Company measure performance excluding the intra-group reinsurance arrangements. Therefore, the commentary in the sections below is based on the pre-intra-group reinsurance result of the Company.*

Gross written premium increased by £61.5 million to £357.6 million (2019: £296.1 million). £16.8 million of the increase was driven by one-off events in the year, namely a change in estimation basis, which increased premium by £28.1 million, which was offset by an £11.3 million decrease in premium resulting from the Part VII transfer.

Excluding these one-off events, premium increased by £44.7 million (15.1%) compared to prior year primarily driven by the hardening London Market rates, new open market contracts and increased binder premiums. In particular the Marine line increased by £24.6 million whilst the UK Regional business generated £20.2 million additional premium compared to 2019.

During 2020 the COVID-19 pandemic continued to develop, contributing to an increase of claims incurred. Whilst the net exposure of the Company was limited to £3.2 million, the gross earned and unearned exposure led to £43.8 million of losses incurred. Management have also reviewed the Company's overall provision in light of the outcome of the FCA's Business Interruption Test Case. The reserves are considered to remain an accurate reflection of the Company's exposure with no material additional provisions arising from the outcome of the test case.

Pre intra-group reinsurance, the loss ratio was 6.5 points higher than 2019 at 66.0% primarily due to larger catastrophe losses in 2020 including those related to COVID-19.

Net underwriting expenses increased by £20.8 million to £105.7 million (2019: £84.9 million), mainly due to growth of the UK Regional business, which incurred higher expense ratios.

The Company has the benefit of a whole account proportional (85%) intra-group reinsurance treaty and a stop loss reinsurance protection with ARL. The internal stop loss reinsurance contract with ARL provides cover up to the lower of 85% of the Company's retained earned premium and \$20.0m, in excess of 110% ultimate net loss ratio. This reinsurance protection enables capital to be provided from Bermuda to support the business written through the Company. The net gain on the whole account intra-group reinsurance treaty and stop loss, before consideration given to the capital benefit, was £11.5 million (net gain 2019: £0.5 million).

The following table sets forth summary information regarding gross and net premiums written, by segment and geographical region.

	2020		2019	
	£'000	% of Total	£'000	% of Total
<b>Gross Premiums Written</b>				
Medical Expenses	2,870	1%	1,253	0%
Income Protection	7,678	2%	14,609	5%
Marine, Aviation and Transport	42,119	12%	11,998	4%
Fire and Other Damage to Property	163,761	45%	126,390	43%
General Liability	121,865	34%	126,242	43%
Non-Proportional Casualty	10	0%	71	0%
Motor vehicle liability insurance	7,984	2%	5,769	2%
Other motor insurance	1,884	1%	5,123	2%
Credit and suretyship insurance	9,392	3%	4,614	1%
<b>Total</b>	<b>357,563</b>	<b>100%</b>	<b>296,069</b>	<b>100%</b>

	2020		2019	
	£'000	% of Total	£'000	% of Total
<b>Gross Premiums Written by Risk Location</b>				
United Kingdom	272,497	76%	198,383	67%
United States	14,690	4%	16,668	6%
Zimbabwe	4,078	1%	-	0%
Norway	3,327	1%	3,740	1%
Chile	3,180	1%	178	0%
Ghana	2,576	1%	429	0%
Other EEA Countries	8,623	2%	47,590	16%
Other Non EEA Countries	48,592	14%	29,081	10%
<b>Total</b>	<b>357,563</b>	<b>100%</b>	<b>296,069</b>	<b>100%</b>

	2020		2019	
	£'000	% of Total	£'000	% of Total
<b>Net Underwriting Result*</b>				
Medical Expenses	254	-3%	(48)	0%
Income Protection	590	-7%	(753)	6%
Marine, Aviation and Transport	1,019	-11%	1,475	-12%
Fire and Other Damage to Property	(3,393)	38%	(5,602)	44%
General Liability	(6,948)	79%	(5,239)	41%
Non-Proportional Casualty	(4)	0%	(67)	1%
Motor vehicle liability insurance	108	-1%	(812)	6%
Other motor insurance	(397)	4%	(1,185)	9%
Credit and suretyship insurance	(78)	1%	(592)	5%
<b>Total</b>	<b>(8,849)</b>	<b>100%</b>	<b>(12,823)</b>	<b>100%</b>

#### Net Underwriting Result by Risk Location

United Kingdom	(7,338)	83%	(10,117)	79%
United States	(271)	3%	(1,608)	13%
Zimbabwe	(60)	1%	-	0%
Norway	(69)	1%	(103)	1%
Chile	(66)	1%	7	0%
Ghana	(39)	0%	18	0%
Other EEA Countries	(164)	2%	(2,195)	17%
Other Non EEA Countries	(842)	9%	1,175	-10%
<b>Total</b>	<b>(8,849)</b>	<b>100%</b>	<b>(12,823)</b>	<b>100%</b>

The table above excludes investment income expense.

The segment and geographical location business mix has seen a shift from EEA business post Brexit and an increase in UK business due to the UK Regional acquisition.

The overall net underwriting loss was primarily driven by an increased loss ratio due to losses arising out of the COVID-19 pandemic.

### A.3 Investment Performance

The Company's investment portfolios primarily consist of highly rated fixed income securities and cash, these have an average S&P rating of AA+. These are available to settle insurance and reinsurance liabilities to third parties. Our aggregate invested assets at 31 December 2020 totalled £77.1 million (2019: £74.0 million).

The distribution of our fixed income and other investments by type is shown below. This excludes holdings in related undertakings:

Asset Type	2020		2019	
	£'000	%	£'000	%
Government Bonds	35,709	46%	45,304	61%
Corporate Bonds	20,497	27%	24,231	33%
Collateralised Securities	1,627	2%	1,340	2%
Collective Investment Undertakings	19,288	25%	3,172	4%
Other	-	0%	-	0%
<b>Total</b>	<b>77,121</b>	<b>100%</b>	<b>74,047</b>	<b>100%</b>

The components of net investment income included in the statement of income and expenses are as per the table below:

	2020		2019	
	£'000	%	£'000	%
Government Bonds	879	68%	149	19%
Corporate Bonds	581	45%	577	73%
Collateralised Securities	11	1%	28	4%
Collective Investment Undertakings	(176)	-14%	33	4%
Other	-	0%	-	0%
<b>Total Investment income</b>	<b>1,295</b>	<b>100%</b>	<b>787</b>	<b>100%</b>
Net investment expenses	(257)		(203)	
<b>Net investment return</b>	<b>1,038</b>		<b>584</b>	

The net investment return, excluding dividend from the subsidiary and foreign exchange difference, was £1.0 million in 2020 (2019: £0.58 million). The net investment return includes investment charges and unrealised gains and losses recognised in other comprehensive income. Effective net investment return was 1.3% (2019: (0.8%)).

#### A.4 Performance of Other Activities

The following table summarises the other income and expenses for the year ended 31 December 2020 and year ended 31 December 2019.

£'000	2020	2019
Net Foreign Exchange Losses	(607)	-
Net Foreign Exchange Gain	-	838
<b>Total Foreign Exchange Gains / (Losses)</b>	<b>(607)</b>	<b>838</b>

The Company's foreign exchange gains and losses are from the translation of subordinated currency positions that are different to the functional currency of the Company. The main subordinated trading currencies are Euros, United States Dollars and Australian Dollars.

Though the Company's policy is to match the assets and liabilities of these subordinated currency positions, in most cases there is a small surplus held at balance sheet date due to timing of movement in assets and liabilities and the timing of actions taken to remediate the matching positions.

AIUK has no lease arrangements as at 31 December 2020. All services are recharged to the entity from AEIS.

## **A.5 Any Other Information**

No other information to report as of 31 December 2020.

## SECTION B System of Governance

### B.1 General Information On The System of Governance

#### B.1.1 Overview

Given the nature, scale and complexity of the risks inherent in our business, the Board of the Company considers the Company's System of Governance to be adequate for a Company which is classified as a Category 4 firm under the PRA's five categories framework, which is defined as a Company whose:

*'size, interconnectedness, complexity and business type give them very little capacity individually to cause disruption to the UK financial system by failing or by carrying on their business in an unsafe manner, but where difficulties across a whole sector or subsector have the potential to generate disruption. Insurers whose size (including number of policyholders) and type of business mean that there is very little capacity to cause disruption to the interests of a substantial number of policyholders.'*

The purpose of the Board is to act as the main governing body of the Company, and this is detailed in the Board's Terms of Reference, which include a schedule of matters reserved for the Board of Directors.

The Board is responsible for overseeing, controlling and directing the activities of the Company. The Board retains primary responsibility for corporate governance within the Company at all times. This includes supervising a suitable business organisational structure and culture to achieve the business goals, setting senior management performance objectives aligned with strategy and policies and ensuring that there is effective information and reports on all matters for monitoring of key risk drivers or key decision making.

The Board is intended to operate as an effective, balanced body of qualified persons, with appropriate skill sets, collectively guiding the performance in the objective best interests of the Company and its wider stakeholders under the leadership of the Chairman, who shall cater for the appropriate exposure and escalation of important matters into the full Board for discussion as required.

The terms of reference of the Board require the composition of the Board to be balanced, including a mix of executive and non-executive Directors. The terms of reference require at least two fully independent non-executive Directors in order to provide an objective counterpoint to group considerations in the constructive review and discussion by the non-executives of the proposals, actions and performance of the executive management team.

The Board of Directors of the Company consists of Nine Directors of which two are Independent Non-Executive Directors, namely the Chairman of the Board (SMF9) and the Chairman of the Audit Committee (SMF11). The Board also has three "Group" Non-Executive Directors.

- S. Bashford (Chief Underwriting Officer, SMF23)
- N. Denniston (Independent Non-Executive and Chairman, SMF9, and Chair of the Remuneration Committee, SMF12)
- J. Kittinger (Chief Financial Officer, SMF2)
- P. Leoni (Chief Underwriting Officer, SMF23)
- J. Mentz (Group Non-Executive, "Notified NED")
- A. Flanagan (Group Non-Executive Director, "Notified NED")
- M. Hammer-Dahinden (Group Non-Executive Director, "Notified NED")
- P. Storey (Independent Non-Executive, Chairman of the Audit Committee, SMF11)



- H. Sturgess (President and Chief Executive Officer, SMF1)

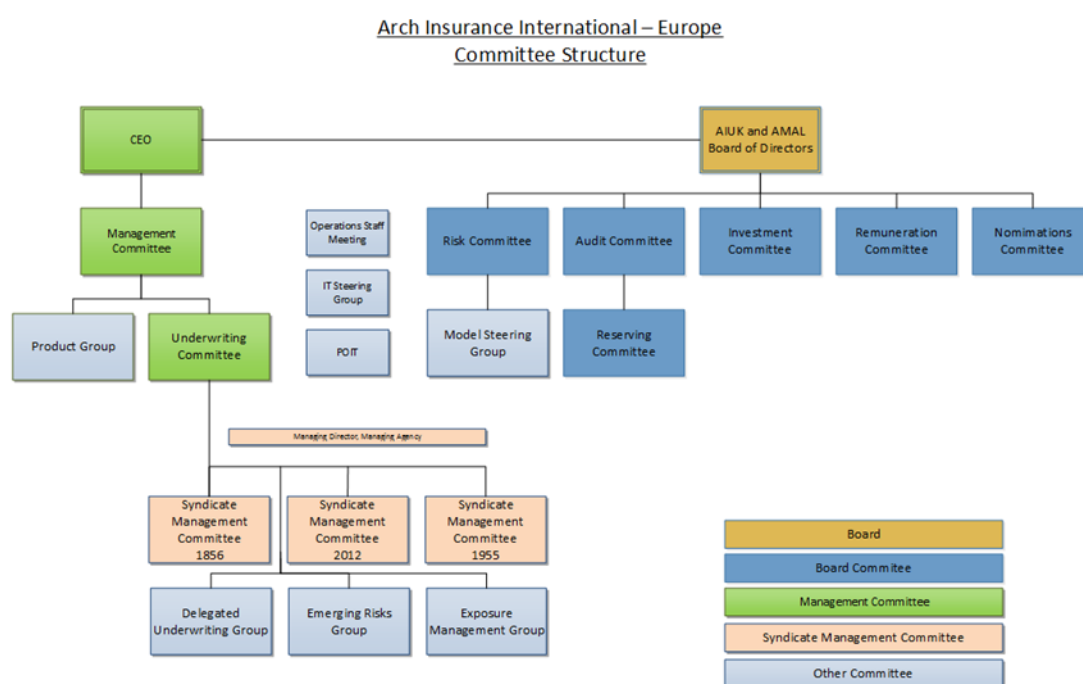
The registered Company Secretary is Paul Ralph (appointed 1 November 2020).

### B.1.2 Board Committees

The Articles of Association of the Company allows the Board to delegate powers to individual Directors or to any committee consisting of one or more persons, whilst still retaining responsibilities. Where such a committee is established, its proceedings and decisions must be fully reported to the Board at the next meeting following each meeting of the committee.

The activities and effectiveness of the Committees are reviewed and evaluated at the quarterly Board meetings by reports from the key officers and special assignments and responsibilities allocated by the Board if deemed necessary.

The Board is supported by the following approved committees operating under the agreed set of terms of reference for each of the committees.



### Audit Committee

The Audit Committee is a full committee of the Board charged with oversight of financial reporting, disclosure and the control environment.

The Audit Committee is appointed by the Board from amongst the Non-Executive Directors of the Company, chaired by an independent Non-Executive Director and consists of no less than three members. The members are selected on the condition of possessing the necessary skills to carry out the role effectively.

The key responsibilities of the Committee are to assist the Board of Directors in the oversight of:

- the integrity of all regulatory and statutory financial reporting;
- the effectiveness of the internal controls framework;
- the appointment of independent external auditors and their performance;
- the performance of the Company's Internal Audit function; and
- to review and challenge, where necessary:
  - the consistency of, and any changes to, accounting policies;
  - the methods used to account for significant or unusual transactions where different approaches are possible; and
  - whether the Company has followed appropriate accounting standards and made appropriate estimates and judgements, taking into account the views of the external auditor.

The Audit Committee meets at least quarterly and reports to the Board on a quarterly basis.

### Risk Committee

The Risk Committee is a full committee of the Board charged with assisting the Board in fulfilling its oversight responsibilities with regard to the risks inherent in the operations of the Company as well as the control processes with respect to such risks, the assessment and review of the key risk categories and the risk management activities of the Company and its subsidiary.

The Risk Committee consists of Non-Executive Directors of the Company chaired by an independent Non-Executive Director. Normal attendees include the Chief Risk Officer ("CRO"), members of senior management and other control owners and specialists.

The key responsibilities of the Risk Committee are to:

- oversee the Risk Management Framework which includes the overall risk appetite, risk policies, risk register and Capital Modelling;
- oversight of the Risk Management and Compliance functions;
- review accumulations, realistic disaster scenarios, stress tests and reverse stress tests;
- review the corporate risk profile and emerging risk;
- review of reinsurance;
- provide the governance around the Own Risk and Solvency Assessment ("ORSA");
- ensure that capital is commensurate with the risks the Company faces;
- to discuss risk events and record any control failures;
- to review the quarterly Risk Metrics and advise the Board on the current risk exposures;
- to keep under review the Company's overall risk assessment processes ensuring both qualitative and quantitative metrics are used; and
- to oversee the implementation of the Company's Compliance Policy.

The Risk Committee meets quarterly and reports to the full Board on a quarterly basis through the respective reports of the CRO and the Chair of the Risk Committee.

## Remuneration Committee

The purpose of the Remuneration Committee is to review the overall compensation remuneration for Directors, senior managers and material risk takers.

The Remuneration Committee consists of the Independent Non-Executive Chairman of the Board, the Senior Independent Director (or Independent Non-Executive Director), the Chief Executive Officer (“CEO”), and an Executive Director of ACGL Worldwide Insurance Group acting in the capacity as a Group Non-Executive Director (Notified NED) for AIUK. From time to time, others may be in attendance as required.

The key responsibilities of the Committee are:

- To provide independent review of individual determinations of compensation considering the Remuneration Policy so that awards cater for strong alignment with the interests of Arch Insurance Europe and Arch Capital Group and their stakeholders.
- To ensure that compensation is viewed in totality and is proportionate to both responsibility and performance.
- To ensure sound risk taking and ethical behaviour are acknowledged.
- To ensure that compensation is market competitive through periodic surveys and studies of peer organisations and is generally consistent with the objective of proactive talent management.

The Remuneration Committee meets at least annually and reports to the Board as required.

## Nominations Committee

The purpose of the Nominations Committee is to review and agree the nominations to the Board for Directors and Senior Management employed by the Company.

The Nominations Committee consists of the Independent Non-Executive Chairman of the Board, the Senior Independent Director (or Independent Non-Executive Director), the CEO, and an Executive Director of ACGL Worldwide Insurance Group acting in the capacity as a Group Non-Executive Director (Notified NED) for AIUK. From time to time, others may be in attendance as required.

The key responsibilities of the Nominations Committee are:

- To regularly review the structure and size (including the skills, knowledge, experience and diversity) of the Board and make recommendations to the Board with regard to any changes;
- Identify and nominate, for the approval of the Board, candidates to fill Board vacancies as and when they arise, having first evaluated the balance of skills, knowledge, experience and diversity on the Board; and
- Review the assessments of the CEO regarding appointments to senior management and succession planning.

The Nominations Committee meets at least annually and reports to the Board as required.

### Investment Committee

The purpose of the Investment Committee is to review and propose changes to the investment strategy, monitor and review investment performance, consider Investment Risk Policies and controls and to monitor the quality of collateralised trust assets.

The Investment Committee is appointed by the Board and consists of senior members of staff who are responsible for managing and controlling investment and market risk. The Board has appointed the Chief Financial Officer (“CFO”) as the Chairman of the Investment Committee.

The Investment Committee consists of the CFO (Chairman), the CEO, the CRO, the Chief Actuary, and one Non-Executive Director. The investment managers and other finance experts are normal attendees.

The Investment Committee meets quarterly and reports to the Board on a quarterly basis.

### Reserve Committee

The purpose of the Reserve Committee is to examine the detailed reserves schedules for the Company and to propose the reserves to be set for forecasting the result of the underwriting accounts. The Reserve Committee reviews a report prepared by the actuarial department recommending the best estimate level of technical reserves to meet outstanding liabilities, highlighting key uncertainties, significant emerging trends, and consideration of market conditions and benchmarking inputs.

The Reserve Committee is appointed by the Board and consists of senior members of staff who are responsible for managing and controlling insurance risks and reserves. The Board has appointed the CFO as the Chairman of the Committee.

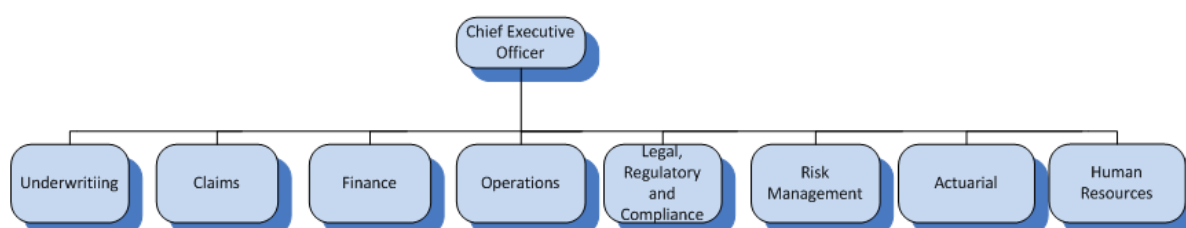
The Reserve Committee consists of the CFO (Chairman), the CRO, the Chief Actuary, the Chief Claims Officer (“CCO”), the independent Non-Executive Directors and a Group Non-Executive Director.

The Reserve Committee meets quarterly and reports to the Audit Committee on a quarterly basis.

### **B.1.3 Organisational Structure and Management Committees**

Subject to the oversight of the Board, the CEO is responsible for apportioning responsibilities amongst fellow executive Directors, senior management and staff and must provide for systems, controls and procedures to ensure that the delegation and segregation of duties are efficient and effective.

The CEO proactively manages the business in accordance with the Strategy and Business Plan and is supported by the senior management team and the Management Committee which comprises the following Heads of Departments covering the main Business Processes and Key Functions.



All teams have appropriate access to individuals and decision making across the business to ensure the proper discharge of their responsibilities. This is accomplished through participation and/or access to appropriate departmental heads, the Management Committee, the Board and the CEO.

The standards for Key Functions are embodied in Terms of Reference. The core emphasis of risk oversight and assurance of the Key Functions interact with the definition of the responsibilities of the Business and Corporate Operations Departments.

### Management Committee

The purpose of the Management Committee is to manage the business on a day-to-day basis to deliver the required return on capital within the agreed risk criteria and to assess and develop the business opportunities and challenges to the Company in accordance with the agreed Board strategy.

The Management Committee is appointed by the CEO and consists of senior members of staff who are specialists in their fields of expertise and possess the necessary skills to support the CEO managing the Company on a daily basis and delivering on the Company's objectives. The final decision-making authority rests with the CEO and he is one of the four Management Committee members who are serving as an executive director on the Board.

The Management Committee consists of the CEO (Chairman), the CFO, the Chief Underwriting Officers ("CUOs"), the CRO, the Chief Actuary, the CCO, the Chief Compliance Officer, the General Counsel ("GC") and the Chief Administration Officer ("CAO").

On a weekly basis, the key responsibilities of the Management Committee are to facilitate open debate on the tactical direction of the business and to enable all members to report on any changes and issues in their business areas.

On a periodic basis, the key responsibilities of the Management Committee are to receive reports from all the business areas and to discuss and approve all findings, recommendations and reports that will be presented to the Board and the ACGL Group.

The Management Committee meets on a weekly basis. The Management Committee is supported by the Underwriting Committee.

### Underwriting Committee

The purpose of the Underwriting Committee is to review, monitor and oversee the development of all aspects of the underwriting business carried out by the Company, and make recommendations on such to the Management Committee.

The Underwriting Committee consists of senior members of staff who are responsible for managing and controlling underwriting risks and business development. The CEO acts as the Chairman of the Underwriting Committee.

The Underwriting Committee consists of the CEO, the CUOs, the CRO, the Chief Actuary, the CCO, and heads of underwriting divisions and underwriting teams.

The key responsibilities of the Underwriting Committee are:

- to identify and oversee market entry strategies for new lines of business and new territories, including oversight of proposed business plans, distribution and recruitment strategies;

- to perform periodic profitability reviews of each line of business underwritten by the Company, for the purpose of making recommendations to the Management Committee regarding the appropriate mix of business for the Company and any changes thereto;
- to review proposed annual business plans for each line of business underwritten by the Company prior to the submission of such business plans;
- to receive and review reports from the Ceded Reinsurance Department detailing the structure, cost and performance of the reinsurance programmes inuring to the benefit of the Company; and
- to sign off inputs into the internal model including: Gross written premium and Gross ultimate loss ratios, Underwriting Policies, Premium Adequacy and Risk Selection.

The Underwriting Committee meets quarterly and reports to the Management Committee on a quarterly basis. It has attached groups to consider Emerging Risk, Products, Key Binding Authorities and Exposure Management.

#### **B.1.4 Code of Business Conduct**

The Company has adopted ACGL Group's Code of Business Conduct, which describes ethical principles, the priority on maintaining a culture of integrity and key areas of compliance. The full text of our Code of Business Conduct and our Corporate Governance Guidelines are available on the Company's website located at [www.archcapgroup.com](http://www.archcapgroup.com).

#### **B.1.5 Independent Control Functions**

The Company has in place five key independent control functions as required under the Solvency II Directive. These are:

- Risk Management;
- Compliance;
- General Counsel Office and Legal Department;
- Actuarial; and
- Internal Audit.

These functions are responsible for providing oversight of and challenge to the business and for providing assurance to the Board in relation to the Company's control framework. These functions have the authority, independence and resources to carry out their tasks and details of the committees are contained within **Sections B.1.2 & B.5**

### **B.1.6 Risk Management Function**

The CRO is the Key Function Holder for the Risk Management function.

The CRO's primary responsibility is to the Board, and reports to the Board periodically with direct access to the Chairman of the Board. The CRO also reports to the Risk Committee, at least quarterly.

The key responsibilities of the Risk Management function are:

- Ensure that the Company has and maintains effective processes to identify, monitor, manage and report on the risks to which it is or might be exposed;
- Run the ORSA Process and produce the ORSA Report;
- Advise on Risk Strategy and recommend Risk Appetites in relation to the Business Strategy;
- Provide an effective Risk Management Framework including Policies on the main categories of risk and monitoring operational risk;
- Operate an effective Risk Governance system to embed risk consideration in decision making;
- Ensure that concentrations and accumulation of risk are well identified, analysed and monitored;
- Coordinate Emerging Risk Policy and use of Stress and Scenario Testing;
- Design and review Risk Register and internal controls;
- Provide effective integrated risk monitoring reporting to confirm position relative to appetite and other control points;
- Design, establish governance and test Standard Formula and its relationship with the overall Risk Management System;
- Calculate Solvency Capital and available economic capital;
- Complete and review the validations of the internal model;
- Advise on risk implications of new business or business change; and
- Promote Risk Management culture.

### **B.1.7 Legal, Regulatory and Compliance Function**

The Legal, Regulatory and Compliance Officer ("LRCO") is the Key Function Holder for the Legal, Regulatory and Compliance function.

The Board has approved the adoption of ACGL's compliance and ethics program to ensure that the Company promotes an organisational culture that encourages the highest standards of ethical business conduct and compliance with its Code of Business Conduct, its policy statements and any laws and regulations which govern its business activities (collectively referred to as the "Compliance Program"). The Compliance Program is intended to ensure that the Company exercises appropriate due diligence to prevent conduct which is in violation of its Compliance Policy thereby protecting its reputation and good name.

In addition to being familiar with this Compliance Program, it is essential that employees are familiar with, and in compliance with, any additional compliance policies and procedures adopted to meet the requirements of applicable local law and regulations which may not be covered by this Compliance Program. The Compliance Policy is supported by a Compliance Framework identifying key compliance risks.

The requirements of this Compliance Program and the attendant activities aimed at controlling it are applicable to all employees, officers and Directors of the Company (herein referred to as “employees”). In addition, where appropriate, the Compliance Program also will apply to agents of the Company.

The key responsibilities of the Legal, Regulatory and Compliance function are:

- Advise on and monitor compliance with the Regulatory System;
- Advise on effective governance, individual accountability and corporate secretariat (including commissioning of Board effectiveness reviews);
- Coordinate Content Management of Documentation Framework;
- Monitor and advise on changes in the legal environment and regulatory developments;
- Coordinate engagement with regulatory supervisors;
- Ensure awareness, ownership and coordination of regulatory filings;
- Promote the Compliance Program and whistleblowing;
- Oversee and advise on Conflicts of Interest;
- Ensure adequate Financial Crime Compliance including fraud (as Financial Crime Officer);
- Approve Brokers and oversee elements of Coverholder Approval and complaints;
- Licencing advisory and assurance;
- Data Protection;
- Advise on Data Retention and issue litigation hold notices;
- Coordination of the Customers Conduct Framework;
- Advice on commercial contracts and insurance contracts;
- Handle non-coverage litigation;
- Coordination of content to Board and Company Secretarial; and
- Coordinate Framework for Overseas Offices.

#### **B.1.8 Actuarial Function**

The Chief Actuary is the Key Function Holder for the Actuarial function. The key responsibilities of the Actuarial function are:

- Analytical support for Business Plan performance monitoring by management;
- Design and operate pricing framework, monitor pricing adequacy and provide opinion on overall underwriting policy;
- Assess and recommend appropriate reserves, comparing best estimates against experience and reconciling booked reserves and movements with the financial reserving process;
- Coordinate the calculation of technical provisions (Solvency II) and opine on their appropriateness;
- Ensure integrity of the reserving process (data, methodologies and assumptions); and
- Evaluate and report with opinion on the adequacy of reinsurance arrangements.



### B.1.9 Internal Audit Function

The Company has an Internal Audit Policy in place which sets out the objectives and responsibilities of the Internal Audit function, which is outsourced to ACGL Group Internal Audit. ACGL Group Head of Internal Audit is the Key Function Holder of the Internal Audit function.

The key responsibilities of the Internal Audit function are:

- Design, undertake and report on risk based, rotational audit plan in order to evaluate the effectiveness of functions, business processes and internal controls;
- Provide assurance over governance and other processes; and
- Independent review and validation of internal model and of the ORSA Process.

Internal Audit is discussed further in **Section B.5** below.

### B.1.10 Remuneration Policy and Practices

As noted previously, the Remuneration Committee is responsible for independent review of the individual elements of total compensation paid to the CEO and our other executive and senior management, and establishing overall compensation policies for our employees. The Remuneration Committee also oversees the administration of executive compensation plans.

The main principles of our strategy include the following:

- compensation decisions are driven by overall long-term collective performance within an approved risk appetite;
- increased compensation is earned through an employee's increased contribution; and
- a proportion of total compensation should consist of variable, performance-based compensation.

Our compensation program includes both fixed and variable compensation, with an emphasis on long-term compensation that is tied to the Company's performance. Although we do not apply rigid apportionment goals in our compensation decisions, our philosophy is that variable pay, in the form of annual cash incentive bonuses and share-based awards, should constitute a significant portion of total direct compensation and be suitably deferred.

A component of variable compensation is granted in the form of annual multi-year vesting share-based awards, which make stock price appreciation over an extended period of time fundamental in realising a compensation benefit. By emphasising long-term performance through using long-term incentives, we align our executives' interests with our shareholders' interests and create a strong retention tool. The Company provides awards in the form of restricted share/unit grants and stock options and share-settled stock appreciation rights ("SARs"), which typically provide for vesting over three years.

The Remuneration Committee considers both financial performance and strategic objectives in its evaluation process, and generally does not use pre-set performance goals. Instead, the Remuneration Committee (i) reviews performance on an annual basis; and (ii) applies its business judgment to review bonuses and the overall amount and mix of compensation elements. The Remuneration Committee believes this structured and disciplined evaluation process in administering the Company's compensation programs enables us to respond more flexibly to changes in the business environment as well as the Company's operations.

#### **B.1.11 Supplementary Pension / Early Retirement Schemes**

The Company contributes to a defined contribution Group Personal Pension Plan. The assets of the scheme are held separately from those of the Company in an independently administered fund.

The Company does not maintain any defined benefit retirement or pension plans.

#### **B.1.12 Material Transactions**

Following the decision of the UK referendum vote in favour of leaving the EU, the parties agreed to a trade deal on 24 December 2020, which does not currently cover financial services. To manage the regulatory risk arising out of the Brexit vote, the Company completed a Part VII transfer of its EEA policies (excluding inwards reinsurance) written between 26 November 2003 and 31 December 2020, to AIEU. Further details of the Part VII transfer can be found on page 5.

In addition, as set out on page 7, the COVID-19 pandemic has led to significant losses to the Company for the year. The Company's gross exposure is £43.8 million, whilst the Company's reinsurance program has reduced the net exposure to £3.2 million. The reserves have been reviewed in light of the FCA court case ruling and are considered to remain adequate.

Other than as noted above, we are not aware of any material insurance or other business transactions between the Company and shareholder controllers, persons who exercise significant influence, the Board or senior executives during the reporting period, except for the whole account proportional (85%) intra-group reinsurance treaty and a stop loss reinsurance protection with ARL. The net gain on the whole account intra-group reinsurance treaty and stop loss was £11.5 million for the full year (net gain 2019: £0.5 million).

The net receivables owed by ARL under the intra-group reinsurance agreement are collateralised by a portfolio of high grade bonds and cash. The trust fund has been established in adherence with PRA admissibility rules under Solvency II. Management continues to use this guideline as the benchmark in managing the trust assets. The collateral arrangement conforms to Article 209 of the Commission Delegated Regulation (EU) 2015/35.

The trust fund agreement stipulates that the value of the trust should be at all times more than 100% of the reinsured liabilities. The trustees of this trust are independent of the Group, being the Bank of New York Mellon, Pittsburgh. The trust fund has been monitored during the COVID-19 pandemic and has been increased to take into account the change in the equity valuations within the fund to ensure the required surplus is maintained.

## **B.2 Fit and Proper Requirements**

### **B.2.1 Fit and Proper Process**

The Company's Fit and Proper policy sets out the guidelines to ensure that employees meet the Fit and Proper regulatory standards as set out in the Senior Managers and Certification Regime (SMCR), both on entry and throughout their employment at the Company. The CEO is responsible for implementing this policy through the Human Resources function, while the LRCO is responsible for providing advice, implementing a monitoring program and reviewing the policy at least annually.

Individuals performing certain Senior Manager Functions ("SMF") are subject to regulatory pre-approval. These roles receive Prescribed Responsibilities and Expected Responsibilities which are specified by the regulator and recorded in the Responsibilities Map. The LRCO identifies and maintains a record of these functions and individuals as well as other employees subject to Certification.

Key Function Holders, including non-executive Directors not otherwise preapproved, are required to be notified to the regulator once the firm has satisfied its own Fit and Proper procedures.

In accordance with its obligations under the SMCR, the Company has identified those employees who are considered to be "Certified Persons" and need to be certified as being Fit and Proper for the role on an annual basis. These are people who owing to the nature of their role is one that involves or may involve a risk of significant harm to the firm or its customers. This population of people includes both Significant Management Functions and Material Risk Takers.

### **B.2.2 Professional Qualifications, Skills and Expertise**

The Company ensures that all persons who hold key positions or functions are fit to provide sound and prudent management through their professional qualifications, knowledge and experience and are proper by being of good reputation and integrity. All employees are monitored on an on-going basis through a formal performance appraisal process.

The Company assesses the professional competence of its managers and employees, specifically focusing on management competence and technical competence (including previous experience, knowledge and professional qualifications) by:

- Following a thorough and robust recruitment process including specification of responsibility, considering competency and suitability, with review and discussion by the Nominations Committee of the Board for senior appointments;
- Completing screening of successful candidates comprising various checks which vary according to the level of the role and include criminal record, financial soundness checks and employer references addressing a candidate's regulatory professional and disciplinary track record;
- Ongoing monitoring of managers and employees professional competence through performance appraisals. Formal performance appraisals are performed annually, and records maintained on file. Non-executive Board members undergo periodic individual and collective self-appraisal; and
- Ongoing training and development to ensure competency and ethical propriety is maintained. This includes in-house training such as code of conduct training, anti-harassment training and anti-money laundering. Training and development needs are formally assessed at least annually, and records are maintained on file.

## **B.3 Risk Management System including the Own Risk and Solvency Assessment (“ORSA”)**

The Risk Management System is integrated into the organisational structure through the Risk Management function.

The Risk Management System is based on an analysis of material risks to which the Company is exposed. Identified risks are assessed in the Risk Register, considering risk drivers, key controls, and the availability of any mitigation. Clear risk owners are also assigned for each item and reports are provided on control effectiveness and key risk indicators. Risk events are logged to improve the control environment. Key risk indicator and performance against the risk appetite statements are reported to the Risk Committee in the CRO Risk dashboard, together with emerging risk.

The Risk Management Framework exists in order to support the maintenance of a more sustainable business model and the achievement of a better business result over time for the Company.

The application of the above to the Company is intended to be proportionate to the nature, scale and complexity of the operations of the business. Based on the scale of the Company and the available resources, the management and the Board have elected to operate as follows:

- a flat risk governance structure, leveraging available human resource with the first and second lines of defence working in partnership to improve the quality of material decision making and to assume responsibility within processes, implying sufficiently segregated additional expert review and/or proportionate committee oversight;
- a dominant focus on managing risk in the portfolio, with particular reference to the underwriting portfolio which is the principal area of business expertise, and to risk in the investment portfolio; and
- an approach to operational risk by managing and reducing exposure through systems and controls and proportionate resource, whilst recognising that people, culture, and reputation are vital underpinnings of the business franchise.

The preferred model for engaging with the firm in order to enhance the profile of risk consideration in decision making is to operate a system of integrated technical (the Board and Risk Management) oversight whilst promoting devolution of certain risks and their monitoring to specific governance committees more proximate to the flow of the business. The Risk Register is consolidated accordingly.

### **B.3.1 Risk Management Process and Procedures**

The following narrative provides an overview of the Company’s Risk Management Framework, which describes the Company’s methodology for identifying, measuring, managing, monitoring and reporting on the key risks affecting the Company. The framework provides a disciplined and structured process that integrates risk management activities into the whole organisation through the Risk Management function. It outlines the Company’s approach to risk identification and assessment and provides an overview of its risk appetite and tolerance for each of the following major risks:

- Insurance risk;
- Investment risk including Market risk;
- Credit risk;
- Operational, including governance, regulatory, conduct, business/strategic, investor relations (reputational), rating agency and outsourcing risks;

- Liquidity risk;
- Group risk; and
- Emerging risk.

The framework includes details of the Company's:

- Risk philosophy and policies to address the material risks confronting the Company; and
- Compliance, approach and procedures to control and/or mitigate these risks.

The actions and policies implemented to meet the Company's business management and regulatory obligations form the core of this framework. The Company has adopted a holistic approach to risk management by analysing risk from both a top-down and bottom-up perspective.

The Company's risk appetite is a fundamental component of its business strategy and business plan. To achieve its business strategy, the Company recognises that it is necessary to assume insurance, credit, and investment risks through the products it sells and the investments it makes with available funds, throughout the underwriting cycle. The business strategy also necessitates assuming operational risks through people, process and technology. In addition, the Company is exposed to and seeks to mitigate liquidity risks and to minimise group-specific risk.

### **Risk Identification and Assessment**

The Risk Committee and Audit Committee oversee the top-down and bottom-up review of the Company's risks. Given the nature and scale of the Company, these committees consider underwriting, investments and operational risks within the scope of the assessment. The CRO assists these committees in the identification and assessment of all key risks.

The CRO is responsible for maintaining the Risk Register and continually reviewing and challenging risk assessments, including the impact of emerging risks and significant business developments. Board approval is required for any new high level risks or change in inherent or residual designations.

### **Risk Management and Monitoring**

The Company's Risk Management Framework requires risk owners to monitor key risks on a continuous basis. The highest residual risks are actively managed by the Risk Committee. The remaining risks are managed and monitored at a process level by the risk owners and the CRO.

Risk owners have ultimate responsibility for the day-to-day management of each designated risk, reporting to the CRO on the satisfactory management and control of the risk and timely escalation of significant issues that may arise in relation to that risk.

The CRO is responsible for overseeing the monitoring of all risks across the business and for communicating to the relevant risk owners if he becomes aware of issues, or potential and actual breaches of risk appetite, relevant to the assigned risks.

A key element of these monitoring activities is the evaluation of the Company's position relative to risk tolerances and limits approved by the Board.

## **Risk Reporting**

The CRO compiles the results of the key risk review process into a reporting pack to the Risk Committee for review and discussion at their quarterly meeting. The report includes:

- An overview of selected key risks (e.g. Insurance, Market, Credit);
- Changes in the rating of high level risks in the Risk Register;
- A risk dashboard that depicts the status of risk limit and tolerance metrics;
- Summary of largest exposures and concentration risks; and
- Reinsurance arrangements, including outstanding and uncollectible recoveries.

If necessary, risk management matters reviewed at the Risk Committee meeting are presented to the Board for discussion. The CRO is responsible for immediately escalating any significant risk matters to senior management, the Risk Committee and/or the Board for approval of the required remediation.

### **B.3.2 Implementation and Integration of ORSA**

The Company believes an integrated approach to developing, measuring and reporting its ORSA is an integral part of the Risk Management Framework. The ORSA process provides the link between the Company's risk profile, its Board-approved risk appetite including approved risk tolerances and limits, its business strategy and its overall solvency requirements.

The ORSA is the entirety of the processes and procedures employed to identify, assess, monitor, manage, and report the short-term and long-term risks the Company faces – or may face – and to determine the capital necessary to ensure that overall solvency needs are met at all times. The ORSA also makes the link between actual reported results and the capital assessment.

The ORSA process and reporting are integral parts of the Company's business strategy, tailored specifically to fit into the organisational structure and Risk Management System with the appropriate techniques in place to assess its overall solvency needs, taking into consideration the nature, scale and complexity of the risks inherent in the business.

The Company also takes the results of the ORSA into account for its system of governance, including long-term capital management, business planning and new product development. It also contributes to various strategic decisions, including how best to optimise capital management, establishing the most appropriate premium levels and deciding whether to retain or transfer risks.

The ORSA is the basis for risk reporting to the Board and its committees and acts as a mechanism to embed the Risk Management Framework within the Company's decision making processes and operations. The Board has delegated responsibility for supervision and oversight of the ORSA to the Risk Committee. This oversight includes regular reviews of the ORSA process and output.

An ORSA report is produced at least annually and the results of each assessment are reported to the Board. The Board actively participates in the ORSA process by steering how the assessment is performed and challenging its results, including suggesting and challenging stress scenarios. This assessment is also taken into account when formulating strategic decisions for the Company.

### **B.3.3 Relationship between the ORSA, Solvency Needs, and Capital and Risk Management Systems**

The Company has both a Capital Management Policy and Capital Management Plan in place. The Risk Management function is responsible for developing and maintaining the Capital Management Plan. The Risk Committee reviews and monitors the plan and presents it to the Board for approval.

The Capital Management Plan incorporates the output from the ORSA and associated reporting. The plan also sets out triggers for corrective capital actions relative to the Company's solvency requirements, the Solvency Capital Requirement ("SCR"), Minimum Capital Requirement ("MCR") and the adjusted net asset basis.

The Company's capital planning process aims to be dynamic and forward-looking in relation to its risk profile and takes into account the output from the risk management activities and the ORSA process and associated reporting as part of capital planning activities.

As such, capital planning activities take into account any current or anticipated changes in the Company's risk profile, such as those reflected in its business plan, and forecasting the related impact on capital. In addition, as part of its capital planning, the Company integrates projected capital needs with its business planning and financial forecasting processes.

The Capital Management Plan identifies a number of potential sources of capital and associated corrective actions that may be utilised to restore sufficient capitalisation, depending on the severity of the capital requirements placed upon the Company.

When considering the sources of capital and corrective actions, the Company will have regard to the classification and eligibility of own funds under Solvency II.

Any material changes in the underlying risks, such as changes in business mix, reinsurance strategy and investment strategy, are modelled for potential impact on the Company's capital requirements. The result of this process is to ensure that all material risks feed into the capital requirements analysis, and in some cases also trigger further investigation through stress testing.

### **B.3.4 ORSA Approval Process**

The Company records the actual performance of the overall capital assessment and the assessment of any deviations in its risk profile from the assumptions underlying the capital requirements analysis.

The CRO prepares a quarterly report for the Risk Committee covering risk management in general, including relevant ORSA topics, for discussion in the Risk Committee meetings. Any material changes in the risk management strategy, policies, processes, procedures and/or capital requirements analysis are presented to the Board for approval.

The ORSA policy and the ORSA report are reviewed by the CRO, Risk Committee and recommended to the Board for approval.

The ORSA report has now been through a number of annual iterations. We believe that the ORSA process including the Board review and approval is both robust and fully embedded within the business and is providing the Board with an explicit lens into the business from a risk and capital perspective. This is overlaid by the more detailed quarterly CRO risk reporting, through Risk Committee and the Board meetings.



## B.4 Internal Control System

### B.4.1 Internal Control System

The Company aims to maintain a strong and robust control culture that underpins all aspects of the integrated operations. It is embedded in the Company's philosophy and approach that complies with best practice and with applicable laws and regulations.

As part of this culture, the Company has established an Internal Control Framework and Risk Management System. The Risk Management System comprises administrative and accounting procedures as well as appropriate reporting arrangements at all levels of the integrated operations, which are supported by actuarial, internal audit and compliance functions. All of these form part of an effective internal control environment within the Company.

The Internal Control Framework is adopted by the Board. The product of analysis within the Internal Control Framework serves to provide the Board and management with relevant confirmations in terms of specific regimes related to the financial environment (Sarbanes-Oxley Act of 2002 ("SOX"), financial reporting, reporting of "economic" condition for Solvency II and Pillar 3), Enterprise Risk Management and regulatory compliance standards.

### B.4.2 Internal Control Framework

All employees within the Company are responsible for managing risk and controls and as a result a large number of individuals are directly involved in the risk management process. The Company has adopted a 'three lines of defence' approach to manage risks.

Under the oversight and direction of senior management and the Board, three separate groups (or lines of defence) are essential for effective management of risk and control. Each of the three lines plays a distinctive role within an organisation's wider governance framework as follows:

- **First Line (business operations):** seen as a crucial element as they are responsible for identifying and managing risk and controls (design and operations), also ensuring that a risk and control environment has been established as part of day-to-day operations. The first line therefore owns the risks, and the design and execution of the organisation's controls to respond to those risks;
- **Second Line (management assurance):** is responsible for ongoing monitoring of the design and operation of controls (established by first line), as well as providing advice and facilitating risk management activities such as promoting the risk framework and systems as part of the day-to-day activities; and
- **Third Line (independent assurance):** includes internal audit who provide independent assurance over the management of risks through the performance of audits and assurance reviews. Our audit committee forms our third line of defence. The three lines of defence model provides a simple and effective way to enhance communications on risk management and control by clarifying roles and duties.



### B.4.3 Key Procedures within the Internal Control System

The internal control system must be built on a strong culture which emphasises and demonstrates to all levels of personnel, through policies, procedures and training the importance of internal control. Internal control breaches may also be considered as conduct risk failures.

Internal control consists of five interrelated components (based on a well-known model, COSO Internal Control Framework of Treadway Commission). The model derives the way management manages its controls and outlines the components, principles and factors necessary for designing, implementing and conducting internal control. The five components are Control Environment, Risk Assessment, Control Activities, Information and Communication, and Monitoring.

The processes and procedures should encapsulate the following specific principles of the Internal Control Framework which are exercised in the operation of the Company's day-to-day activities:

- **Performance reviews** – Management perform regular analysis of actual activities and results, for example, against:
  - approved underwriting authorities;
  - business plans;
  - periodic and regular operational reviews;
  - key metrics; and
  - other key performance, risk and control indicators.
- **Segregation of duties** – The authorisation, execution and record keeping for transactions is segregated between personnel.
- **Authorisations** – Any activity resulting in additional obligations by the Company must be authorised by an appropriate person. The authority for individuals or roles to bind or approve specific transactions, are set out in a Delegation of Authority approved by the Board.
- **Reporting** – Establishing and maintaining clear reporting lines that ensure the prompt transfer of information to all people who need it in a way that enables them to recognise its importance.
- **Reconciliations** – This is the act of matching or balancing one system with another, this should be applied to all systems that have an association in terms of data from one relating to data from another.
- **Financial systems** – Controls over basic payments, income, sales, purchasing, inventory and other financial-based systems are firmly in place.
- **Fraud detection** – Staff assessments and procedures to minimise the risk of fraud and maximise the probability of early detection.
- **Information security** – Established and sound information systems maintained resulting in sufficient, reliable, timely, consistent and relevant information concerning business activities.
- **Physical access restrictions** – Where appropriate, physical barriers and other access controls are maintained to protect assets and property. These include password access restrictions to desktop computers, laptops and tablets, together with download restrictions and an overall policy covering buildings security.
- **Retention of records** – Documentation substantiating all transactions is maintained for a required period of time as set out within the Retention Policy in line with statutory obligations.
- **Staff recruitment, appraisal and training** – HR is responsible for controlling recruitment policies and procedures. These include:

- Assessment of skills, knowledge and experience;
- Professional qualifications;
- Annual performance reviews;
- Independent checks performed for all new joiners;
- Job descriptions for all staff reviewed annually; and
- Ownership and administration of the Fit and Proper process.

The Company is included within ACGL Group Assurance Processes including reviews performed by the ACGL's Corporate Underwriting Services Department and local assessment of Internal Control Over Financial Reporting under the methodologies set out in the U.S. Sarbanes-Oxley Act of 2002.

#### **B.4.4 Compliance Function**

The Company's Compliance function forms part of the Legal, Regulatory and Compliance function with the LRCO as the Key Function Holder.

The primary purpose of the Company's Compliance function is to ensure that integrated operations continue to adhere to the best practice standards for ACGL Group requirements, Prudential Regulation Authority ("PRA"), Financial Conduct Authority ("FCA"), Lloyd's of London ("Lloyd's"), the European Insurance and Occupational Pensions Authority ("EIOPA") and other regulatory requirements and applicable laws. This is achieved by formulating best practice and monitoring adherence to internal strategies, policies, processes and reporting procedures. The key responsibilities of the Legal, Regulatory and Compliance function are set out in **Section B.1.7** above.

The Compliance function is an integral element of the Company's risk management and internal control framework. The purpose of the Compliance function is to assist the Board in achieving its overall strategic objectives by promoting a culture of integrity, ethical conduct and compliance with the laws, regulations and administrative provisions that affect AIUK. The Compliance function is also responsible for the ongoing assessment of any possible impact of changes in the legal environment on AIUK operations, and for the identification and assessment of legal or litigation risk. It also monitors adherence to certain elements of the risk management framework and the reporting thereon to the appropriate forums.

## B.5 Internal Audit Function

Arch Capital Services Inc. (“ACSI”) provides internal audit services (“IAS”) to all ACGL entities, including the Company. As the Company falls within the remit of IAS, it is deemed by the Company that the internal audit (“IA”) function is effectively outsourced to ACSI. IA is led by the Chief Audit Executive (“CAE”) who reports to the Chair of the ACGL Audit Committee and administratively to the ACGL Chief Financial Officer. The VP, Internal Audit Services (UK & Europe) (“VP UK”), reports to the CAE, and is subject to the Conduct Rules and Statement of Requirements for the Senior Insurance Managers Regime (“SIMR”) under PRA requirements.

The IA function is adequately staffed by competent individuals and is objective and independent of the Company’s day-to-day activities. Where necessary, IA utilizes external resources to support its work. Appropriate budgets are set to support IA.

IA has appropriate access to all staff, Senior Management and records, including those relating to third party service providers. No restrictions are placed on the scope of IA’s work. The Risk Committee is required to inform IA of all noted control deficiencies, when losses are sustained or of any definite suspicion of irregularities.

IA’s scope encompasses, but is not limited to, the examination and evaluation of the adequacy and effectiveness of the Company’s procedures and internal controls related to its business operations, financial reporting, governance and risk management functions. In addition, IA may perform special examinations and tasks at the request of management, the Board, or the Audit Committee.

### B.5.1 Internal Audit Policy and Practices

IA is an independent, objective, assurance and consulting activity designed to add value and improve the Company’s operations. It helps management and the Audit Committee to accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.

IA’s practices are detailed in the ACSI Internal Audit Policy and Procedures Manual (the “Policy”) which encompasses the IA Charter. The IA Charter outlines the role, responsibility, remit, objectivity, independence and quality assurance requirements of the function. Both the Policy and IA Charter are subject to review and update in line with changes in recognised professional standards, IA’s internal procedures, Company specific legislation or regulations, as well as taking due account of the specific requirements of Solvency II. The IA Charter is annually reviewed by the CAE and approved by the ACGL Audit Committee. IA governs itself by adherence to the mandatory elements of The Institute of Internal Auditors’ International Professional Practices Framework.

### B.5.2 Internal Audit Reporting

An Annual Internal Audit Plan (“Audit Plan”) is produced and submitted to the Company’s Audit Committee prior to the start of the year to which the Audit Plan pertains. It summaries IA’s risk assessment of the business, the scope of its work, the competencies of the team, and the resources, both internal and external, required to accomplish the Audit Plan. The Plan takes into consideration:

- Management’s view of key and emerging risks;
- The risks per the Company’s Risk Register;

- IA's assessment of the Company's key and emerging risks and related controls and their linkage to historical and planned audits;
- The scope and quality of work performed by other defined Assurance Providers (Per the Combined Assurance Framework) ; and
- Results of IA's process based risk assessment.

The rationale for planned audits is based on a number of factors which include, but are not limited to, the assessed level of risk associated with each business process, planned operational changes, new or expanding lines of business and consideration of the work performed by other assurance providers.

IA maintains regular communication and coordination with other assurance providers in order to identify potential issues and also to leverage upon the work they perform, where applicable. In addition, IA regularly communicates with the LRCO and Chief Risk Officer throughout the year to discuss relevant Risk/IA matters.

IA issues an engagement memo prior to each audit which outlines the scope of the audit, any specific scope exclusions, as well as resources and timing of fieldwork and reporting. During fieldwork, audit procedures will include both substantive testing and control testing (including inspection and/ or re-performance) where appropriate. Audit evidence is retained for all audit work performed.

Subsequent to completion of fieldwork and discussion of findings with management, IA issues a formal deliverable (either a report or a memo where appropriate) for all engagements performed. These reports or memos include management's response for all issues identified along with a target date for remediation. The progress of all management actions is monitored by IA and reported quarterly to the Audit Committee.

In addition to the annual Audit Plan, IA presents a Quarterly Report to the Audit Committee. The Quarterly Report includes (but is not limited to):

- Changes to the original Audit Plan presented to the Audit Committee;
- Status of the audits included on the Audit Plan;
- Results of recently issued audit reports;
- Status of prior audit findings and recommendations; and
- Any other matters which in the CAE or VP UK's opinion requires reporting to the Audit Committee.

IA also issues an annual report to the Audit Committee which includes an assessment of issues raised by all AIUK assurance providers during the year, in order to conclude on the adequacy of the control environment.

### **B.5.3 Maintaining Independence**

IA staff are employees of Arch Group and, per the IA Charter, may not carry out functional / operational roles or hold any functional / operational responsibilities for any entity within the scope of its responsibilities, including the Company. This ensures that the independence of the IA function is maintained. Additionally, the IA Charter and Policy defines conflict of interest situations and measures to be taken to address such situation. IA are required to complete the standard ACGL conflict of interest forms annually. The CAE also confirms the independence of the IA function to the ACGL Audit Committee on an annual basis.

The Internal Audit policy sets out the following specific measures aimed at ensuring independence:

- The Internal Audit function is managed and run by personnel separate to AIUK management.
- The CAE / VP UK has the authority to inform the regulator of any issues should it be deemed necessary.
- The staff in the IA function have no involvement in the day to day operations of the Company.
- IA has access to all staff, management and records and no restriction may be placed on this access or the scope of IA's work.
- Remuneration of the Internal Audit team is not linked to the Company's financial performance. Remuneration of the CAE is approved by the ACGL Audit Committee and remuneration of the VP UK is approved by the CAE under the Arch Group remuneration process.

IA reports directly to the Audit Committee, not to operational management.

## B.6 Actuarial Function

The Actuarial function is an integral part of the Company's Risk Management System. The team, which is separate from the Risk Management function, is led by the Chief Actuary. Actuarial Terms of Reference are in place which state that the Actuarial function must be free from influence from other functions and the Board.

The governance of the Actuarial function (reporting lines, remuneration structure, professional requirements) is such that:

- the Actuarial function is able to function independently and objectively while being sufficiently proximate to enable relevant comment to be made on actuarial matters; and
- conflicts of interest are considered, and appropriate mitigating measures are adopted and documented.

The Actuarial function comprises experienced individuals with in-depth knowledge of and professional qualifications in actuarial and financial mathematics. The Chief Actuary is responsible for the function being staffed appropriately given the nature, scale and complexity of the risks inherent in the integrated operations. The team has appropriate access to all resources and information systems required to discharge its responsibilities.

An integral part of the Actuarial function is the responsibility for supporting the capital planning, reserving, reinsurance, and underwriting performance reporting of the Company.

The main activities of the Actuarial function include:

- providing the senior management with the analytical tools and timely management information to empower them to manage and plan the business effectively;
- providing the Actuarial Function Report to the Board at least annually documenting the tasks undertaken and highlighting any shortcomings identified along with how such deficiencies could be remedied.
- The Actuarial Function Report addresses the activities performed by the Actuarial function in the following areas:
  - Coordinating the calculation of technical provisions;
  - Assessing the sufficiency and quality of the data used in the calculation of technical provisions;
  - Comparing best estimates against experience;

- Informing the administrative, management or supervisory body of the reliability and adequacy of the calculation of technical provisions;
- Expressing an opinion on the underwriting policy with sufficient involvement around the policy;
- Overseeing the calculation of technical provisions in the cases set out in the regulations;
- Rating models, rate adequacy, benchmarking, profitability studies and underwriting strategy;
- Expressing an opinion on the reinsurance policy with sufficient involvement on capital modelling, profitability studies and reinsurance strategy;
- Providing sound FRS 102 reserves and reserving volatility measures as input into standard formula SCR and Solvency II technical provisions;
- Ensuring consistency between Return on Capital measures and Pricing;
- Assisting in the independent validation of the calculation kernel;
- Providing accurate and timely management information;
- Providing plan loss ratios via a bridging analysis; and
- Assessing output that feeds into the ORSA, such as technical provisions, business plan and reinsurance arrangements.

## B.7 Outsourcing

### B.7.1 Outsourcing Policy

The Company defines outsourcing as contracting out part or all of an internal business process to a third party provider (either outside or inside the AGL Group). In this regard, the Company may use the external service provider's processes and controls to perform the agreed upon services. However, the Company will retain all decision making and ultimate responsibility over the business function and maintain the appropriate monitoring mechanisms to ensure adherence to a service level agreement.

The Company has an Outsourcing Policy in place which sets out the following:

- The definition of outsourcing;
- Responsibility for implementation and operation of the policy and consequent controls and processes;
- The criteria for outsourcing;
- The approval and oversight process;
- Contract and legal requirements;
- Conflict of interest;
- Risk assessment and risk mitigation measures; and
- Monitoring and on-going requirements.

The following are the outsourced business processes / functions:

- Investment Management Services (to Arch Investment Managers, Bermuda);

- Business Process support to the business and control functions including SOX and underwriting data administration services. and process support to the Finance, Risk and Actuarial functions (to Arch Global Services, Philippines);
- Internal Audit Services (to ACSI Internal Audit, USA);
- Corporate underwriting services, a division of ACGI Worldwide Insurance Group (UK/USA); and
- Delegated claims management or TPA services (Worldwide).

The Company identifies and monitors qualitative and quantitative performance targets to assess the adequacy of service provision, including to its policyholders, where appropriate.

Each material outsourcing arrangement is reviewed periodically to confirm that the considerations under the agreed Outsourced Service Provider Pre-agreement Considerations checklist continue to be met and that the outsourced arrangement remains fit for purpose.

Outsourcing of risk calculations employing vendor catastrophe models is addressed additionally under the External Models and Data Policy.

Outsourcing in terms of delegated underwriting and administration of claims takes place in accordance with specific due diligence, monitoring and audit procedures which are overseen by the Board and, as to particular aspects, through its committees.

## **B.8 Any Other Information**

No other information to report as of 31 December 2020.

## SECTION C Risk Profile

### C.1 Overview

The Company's Risk Appetite framework provides an expression of the level of risk the Company is willing to accept in pursuit of its strategic objectives. The risk appetite framework provides quantitative and qualitative statements which are used to define the general attitude within the organisation towards the desired level of risk. It not only supports the Risk Management Framework, it also enables the Company to make informed business decisions having regard to the key risks to which it may be exposed by such a decision.

All risks are regularly reviewed at Board committee meetings. The risks can be broadly split into the following categories:

2020 Annual Return Risk Category	Adjusted net asset Basis *			
	SCR £'000	SCR %	SCR £'000	SCR %
Insurance Risk	22,969	50%	22,969	59%
Market Risk	9,262	20%	2,697	7%
Credit Risk	5,296	11%	5,296	13%
Operational Risk	8,851	19%	7,932	20%
Liquidity Risk	-	0%	-	0%
Group Risk	-	0%	-	0%
<b>Undiversified SCR</b>	<b>46,378</b>	<b>100%</b>	<b>38,894</b>	<b>99%</b>
Diversification Credit	(8,025)		(4,522)	
<b>Total SCR</b>	<b>38,353</b>		<b>34,372</b>	

\* The "adjusted net asset basis" is reviewed as part of the Company's internal governance processes, but is not independently audited.

The "adjusted net asset basis" is an additional, internally applied, more prudent measure, that the Board use to monitor solvency, and is not part of the requirements of SII. It is reviewed as part of the Company's internal governance processes, but is unaudited.

Further details of these risk categories, including the key risk exposures, concentrations, mitigation techniques and sensitivities, are set out below.

### C.2 Insurance / Underwriting Risk

#### C.2.1 Key Risk Exposure

Insurance risk is the risk of losses from business written, and includes risks relating to reserves, planned business to be written over the next year, and catastrophe risk. It forms the largest proportion of the SCR at 50% (2019: 37%).

The key insurance risks identified by management are:



- Loss from inadequate reserve provisions;
- Loss due to new business written at inadequate rates; and
- Loss on exposure during the year.

The Company is exposed to the risk of loss, or of adverse change in the value of insurance liabilities due to inadequate reserving assumptions, which includes the fluctuations in the timing, frequency and severity of insured events. This applies to some of the Company's Liability business that has a longer tail, which means greater uncertainty on the reserve development.

Over 2020 we have seen a change in market conditions, and in general have experienced a hardening in rates across a number of our main classes of business. Market conditions appear to be improving, with some lines gaining momentum in the second half of the year, including Energy and Property classes. The Company continues to maintain its underwriting discipline and execute its philosophy on profitable risk selection, in order to mitigate the risk that rates obtained are inadequate to cover the costs associated with those risks.

The exposure during the year includes catastrophe risk. The Company's catastrophe exposure is limited by means of strategic risk selections and mitigated, to some degree, through reinsurance. Exposure arising out of the COVID-19 pandemic is discussed separately in section C.7 below.

### **C.2.2 Material Risk Concentrations**

Realistic Disaster Scenarios ("RDS") are in place for all classes of business, and are monitored regularly at a number of committees, including the Exposure Management Committee, the Underwriting Committee and the Risk Committee.

There are generally no material anticipated changes to risk concentrations over the coming year. However, the UK regional book of business, which is being written by the Company following the acquisition from Geo Underwriting at the beginning of 2019, increased the concentration of risk within the UK, including risks relating to flood exposures.

### **C.2.3 Material Risk Mitigations**

Reinsurance is considered to be the main method of insurance risk mitigation. This consists of a number of arrangements with external reinsurers, including a catastrophe treaty to mitigate UK flood aggregations. The Company also has an 85% intercompany whole-account quota share arrangement with ARL.

The Company does not make use of any complex arrangements, such as catastrophe bonds or any other methods of alternative risk transfer.

In addition, underwriting risk is further mitigated through the following:

- Business performance is monitored regularly, including consideration of market factors, pricing trends and strategic challenges;
- Monthly performance reporting highlighting key metrics for discussion;
- Actual performance is compared against plan each quarter;
- There is regular dialogue with brokers and coverholders to assess the market environment;
- Review of management information received;

- Regular monitoring of exposures through the use of catastrophe modelling tools;
- Regular product and pricing reviews;
- Independent reserves review by external actuaries; and
- Periodic audits of claims handlers.

There are no planned material changes to risk mitigation, and we assume in our planning projections that reinsurance is generally renewed as expiring.

## C.2.4 Stress and Sensitivity Testing

Stress and scenario testing is carried out as part of the ORSA process, which is conducted at least annually. These tests consider moderate as well as extreme but plausible stresses and assess the impact on the Company's capital position.

A sensitivity test is run by changing a single assumption in the capital model in isolation while keeping other assumptions consistent. These sensitivity test have been carried out using the internal model as an approximation to both regulatory and economic capital requirements (both use standard formula). The below assumptions only impact the solvency capital requirement for both regulatory and economic capital, and the solvency ratio has been calculated with the current level of own funds.

Sensitivity Test	Total Own Funds		Net Adjusted Assets	
	Impact on SCR	Impact on Solvency Ratio	Impact on SCR	Impact on Solvency Ratio
Reserve volatility - pessimistic view	0.8%	-2.0%	0.8%	-1.5%
10% deterioration in all loss ratios	21.5%	-42.9%	21.5%	-33.3%
Pessimistic view of average large loss severity	4.5%	-10.4%	4.5%	-8.1%

The impact of above sensitivity tests are in line with the expectations due to the underwriting risk being the largest component of the SCR.

## C.3 Market Risk

### C.3.1 Key Risk Exposure

Market Risk is the risk arising from the level or volatility of market prices of financial instruments, which have an impact upon the value of the assets and liabilities of the Company. This includes the assets and liabilities matching in particular with respect to the duration.

The Company's key market risk exposures are from interest rate and currency risks.

The Company's investment portfolio consists of low risk, fixed income asset classes, including cash, government bonds and corporate bonds. Risks are present due to potential movements in interest rates and any mismatch in durations between assets and liabilities.

The Company is exposed to currency risk for net assets denominated in currencies other than Sterling. The most significant currencies to which the Company is exposed are the U.S. Dollar, the

Euro and the Australian Dollar. Exchange rate risk can occur where there is a currency mismatch between assets and liabilities, particularly if there are significant movements in exchange rates.

### C.3.2 Material Risk Concentrations

The material concentrations of securities are monitored regularly at Investment Committee meetings. The Company's largest exposures as at 31 December 2020 are Blackrock (£18.5 million or 17.2% of capital), Barclays Bank (£6.6 million or 6.1% of capital) and UK GILTs (£17.2 million or 16.1% of capital).

There are no material anticipated changes to risk concentrations over the coming year. However, it is recognised that the markets continue to be volatile, and the Investment Committee continues to monitor the exposures and investment strategy accordingly.

### C.3.3 Market Risk Mitigations

A low risk investment strategy which closely matches liabilities by currency and duration is considered to be the main method of market risk mitigation. The Company does not use exotic or alternative arrangements such as derivatives to minimise market risk.

Invested assets are managed by AIM and are considered to have been invested in accordance with the Prudent Person Principle. In particular, the investment guidelines clearly set out the use of low risk asset classes, namely cash, government bonds and corporate bonds.

Other risk mitigation controls include:

- Quarterly performance and compliance reporting to the Investment Committee;
- Investment Guidelines which are structured to ensure sufficient liquidity and prevent over-exposure to any one risk sector; and
- Quarterly Investment Guideline compliance confirmations issued by Investment Managers.

### C.3.4 Stress and Sensitivity Testing

Stress and scenario testing of market risk is carried out as part of the ORSA process, which is conducted at least annually. These tests consider moderate as well as extreme but plausible stresses and assess the impact on the Company's capital position.

A sensitivity test is run by changing a single assumption in the capital model in isolation while keeping other assumptions consistent. The below assumptions only impact the solvency capital requirement for both regulatory and economic capital, and the solvency ratio has been calculated with the current level of own funds.

Sensitivity Test	Total Own Funds		Net Adjusted Assets	
	Impact on SCR	Impact on Solvency Ratio	Impact on SCR	Impact on Solvency Ratio
50% increase in exchange rate volatility	1.0%	-2.4%	1.0%	-1.9%
All assets held in corporate bonds	0.8%	-2.0%	0.8%	-1.6%
1 notch decrease to all corporate bond ratings	0.8%	-1.9%	0.8%	-1.4%

The impact of above sensitivity tests are in line with the expectations and are not believed to have a material impact on the Company's solvency.

## **C.4 Credit Risk**

### **C.4.1 Key Risk Exposure**

Credit risk is the risk of losses from counterparty defaults, and includes risks relating to reinsurer defaults and other counterparty defaults. There are two parts to the credit risk exposures, (1) cash and investment assets; and (2) insurance assets.

The Company has a low appetite for investment credit risk, which is set out in the Investment Risk Policy approved by the Board. The cash and investment assets credit risk exposure is included in Market Risk in **Section C.3**.

The Credit Risk referred to in this section relates to the possible losses due to unexpected default, or deterioration in the credit standing of the counterparties from insurance contracts. The Company is exposed to credit risk from the following sources:

- Outward reinsurance contracts; and
- Premiums receivable from policyholders and intermediaries.

The key risk is that one or more of these counterparties fail.

### **C.4.2 Material Risk Concentrations**

As noted in the earlier sections, the Company has in place an 85% quota share arrangement with ARL, which potentially exposes the business to a significant level of credit risk. This is mitigated through the use of a collateralised trust fund set up by ARL, with the Company being the sole beneficiary of the trust. Collateral of 100% of the reinsurer obligations is required at any given time, which means that if ARL were to default, the Company would be expected to be able to recover any outstanding balances through the trust. The trust fund deed's guidelines state the fund should have a surplus of 5% at all times.

We expect ARL to remain strongly capitalised, and the level of collateral held as well as the security of ARL is discussed quarterly by the Board.

The external ratings of ARL have been stable over the year in respect of Moody's at A2 (Outlook Stable), and have improved for S&P at A+ (Outlook Stable) and AM Best at A+ (Outlook Stable).

The material concentration of other reinsurers and other counterparty balances held are consistent with the risk exposure above and are monitored regularly at the Risk Committee meeting.

### **C.4.3 Credit Risk Mitigations**

The Company mitigates credit risk through the implementation of appropriate controls, processes and procedures.

Reinsurance and premiums receivable are closely monitored and controlled, with short credit periods mitigating risk exposures. Furthermore, other than the inter-group Quota Share reinsurance, other reinsurance arrangements are split across a number of counterparties, thereby reducing single name exposure.

Collateral in respect of the intercompany quota share is considered to be the main method of credit risk mitigation. In addition, the intercompany quota share itself reduces the level of credit risk in respect of other reinsurers because it covers 85% of any potential reinsurer counterparty defaults.

The trust fund cover is reviewed regularly throughout the year, including using financial plan data to assess the trust fund surplus at the end of each quarter. In addition, credit quality of the trust funds is being monitored and reported quarterly to the Investment Committee.

#### C.4.4 Stress and Sensitivity Testing

Stress and scenario testing of credit risk is carried out as part of the ORSA process, which is conducted at least annually. These tests consider moderate as well as extreme but plausible stresses and assess the impact on the Company's capital position.

A sensitivity test is run by changing a single assumption in the capital model in isolation while keeping other assumptions consistent. The below assumptions only impact the solvency capital requirement for both regulatory and economic capital, and the solvency ratio has been calculated with the current level of own funds.

Sensitivity Test	Total Own Funds		Net Adjusted Assets	
	Impact on SCR	Impact on Solvency Ratio	Impact on SCR	Impact on Solvency Ratio
10% increase in default probabilities	1.8%	-4.4%	1.8%	-3.4%
1 notch decrease to ARL credit rating	1.4%	-3.3%	1.4%	-2.6%
Intercompany quota share collateral reduced by 10% to 90% of reinsurer obligation	4.1%	-9.5%	4.1%	-7.4%

The sensitivities demonstrate that key variations in assumptions around the intercompany quota share arrangement, including the level of collateral held, do not have a material impact to the Company's solvency.

### C.5 Liquidity Risk

#### C.5.1 Material Risk Exposure

Liquidity risk is the risk of the Company's inability to meet its obligations when they fall due either through cash or liquidation of investments and other assets.

Other than insurance liabilities, the main operating liabilities consist of acquisition commission, operating expenses and corporate taxes.

The Company considers its exposure to this risk as low. The Company monitors its liquidity in compliance with its Investment Risk Policy and defined limits and tolerances in respect of the percentage of assets which are invested in liquid investments.

### C.5.2 Risk Mitigation

One of the objectives of the Investment Risk Policy is that the Company shall hold sufficient investment values and investment liquidity to ensure all liabilities are met as they fall due. This includes the investment duration closely matching to the liabilities as set out in the Asset and Liability Matching Policy.

To achieve this objective, the investment risk appetite permits only highly rated securities to be purchased. Risk limits and tolerances have also been set in respect of (i) asset-liability duration matching and (ii) availability of liquid assets. These risk appetites, risk limits and tolerances are monitored by the risk function and reported to the Board and Risk Committee.

Cash flow forecasts are prepared by the Finance function to monitor the liquidity of the Company both on short-term and long-term bases. If there are insufficient funds to meet a large claim payment, the Company will make a cash call to ARL under the quota share agreement.

The Company considers that the composition of its assets in terms of their nature, duration and liquidity are appropriate in order to meet its obligations as they fall due.

### C.5.3 Expected Future Profit

Expected profits included in future premiums ("EPIFP") are profits which result from the inclusion in technical provisions of premiums on existing (inforce) business that will be received in the future, but that have not yet been received.

The table below shows the expected profit in future premiums at 31 December 2020 were £13.6 million (2019: £6.6 million). This represents the future profits expected.

	2020
Expected profit in future premium	£'000
Medical expenses	-
Income protection	-
Marine, aviation and transport	712
Fire and other damage to property	10,882
General liability	1,899
Motor other	-
Motor liability	19
Credit and Surety	75
Casualty Reinsurance	-
<b>Total</b>	<b>13,587</b>

## C.6 Operational Risk

### C.6.1 Key Risk Exposure

Operational Risk means the risk of loss arising from inadequate or failed internal processes, or from personnel and systems, or from external events.

Furthermore, it includes the risk of loss resulting from failure to comply with laws and regulation as well as prudent ethical standards and contractual obligations, and the exposure to litigation from all aspects of business activities.

Operational Risk also includes:

- **Group Risk:** Risks related to unregulated entities within the ACGL Group, implicit or explicit exposure to losses throughout the group (“contagion risk”), risks related to intercompany transactions and double gearing, the extent to which practical, legal, or regulatory barriers to the transfer of capital between group members exist, and other additional risks which individual members of a group face by virtue of their group membership;
- **Strategic Risk:** Risk that strategic business decisions prove to be ill-founded or poorly executed. Examples of such risk include mergers and acquisitions, moving into new markets, business lines, or regions, changes to the operating model, or failing to anticipate or react to a more general shift in the economic environment, demographics etc; and
- **Reputational Risk:** The potential adverse impact of an economic loss through deterioration of reputation, credibility or standing with insurers and coverholders, other customers, brokers and the investor community.

The Company considers regulatory breaches to be the most material Operational Risk, which is consistent with management’s view and reflects the current regulatory environment. Additionally, at the time of writing, operational risks which may be potentially heightened due to the COVID-19 pandemic, are being reviewed on an ongoing basis, including those relating to people, processes and governance.

No historical loss data is available regarding regulatory breaches for the Company. The largest stress test is consistent with one of our reverse stress tests, which is an antitrust violation for price fixing with a return period of 1 in 200 years, leading to a loss of £5.0 million.

The Company applies significant endeavours to avoid legal, regulatory or compliance failure or impairment which may lead to regulatory censure and/or financial penalty and/or harm to its reputation or franchise. A number of risk appetites are discussed quarterly by the Risk Committee, including:

- All agreed actions with the PRA are addressed in a timely manner;
- Conduct risk dashboard; and
- No breaches in respect of financial crime control design or operational sufficiency.

Management has also identified the following other key operational risks:

- Inadequate claims handling;
- Legal, litigation, political and reputational risk;
- Reliance on key individuals (including Directors and staff at outsourced service providers);
- Inappropriate overall business strategy or inadequate monitoring of strategic decisions; and
- Risks external to the Company but internal to the ACGL Group.

Those risks classified under the Operational Risk profile have been identified, assessed and articulated in the Risk Register. Relevant risk and control owners report to the Audit and Risk Committee and are responsible for identifying new, emerging or changing risks and any consequent control changes required to realign the risks with the risk appetite.

With respect to Legal Risk, the LRCO has the responsibility for monitoring new and pending legislation in the UK, EIOPA and relevant bodies in other applicable jurisdictions for items that could potentially impact the Company.

In addition, applicable international risks are identified through discussions, meetings and memos with/from law and accounting firms within the jurisdiction of all ACGL entities.

### **C.6.2 Material Risk Concentrations**

It is noted that we have a number of third party vendors including Global Services in the Philippines. We do not consider any one of these individual third parties to lead to a material level of operational risk concentration.

### **C.6.3 Operational Risk Mitigations**

The Company has put in place a strong internal control framework which mitigates operational risk. In particular, the following are key controls in managing this risk:

- Appropriate segregation of duties across all functions;
- Systems access controls;
- Four-eyes oversight of all key areas;
- Regular management accounting processes including reconciliations and checks;
- Business Continuity and Disaster Recovery Plans;
- All outsourced arrangements conducted under formal agreements and in accordance with the Outsourcing Policy;
- Ongoing oversight and regular audits of outsourced service providers;
- All material contracts reviewed by the LRCO;
- Business plans and budgets reviewed quarterly; and
- Appropriate governance structures, including quarterly Board meetings.

### **C.6.4 Stress and Sensitivity Testing**

Operational Risk is included in the Standard Formula. However, as part of its ORSA process, the Company also considers the following:

A sensitivity test is run by changing a single assumption in the capital model in isolation while keeping other assumptions consistent. The below assumptions only impact the solvency capital requirement for both regulatory and economic capital, and the solvency ratio has been calculated with the current level of own funds.



Sensitivity Test	Total Own Funds		Net Adjusted Assets	
	Impact on SCR	Impact on Solvency Ratio	Impact on SCR	Impact on Solvency Ratio
10% increase in largest operational stress tests	0.0%	-0.1%	0.0%	-0.1%

The impact of above sensitivity test is in line with the expectations and is not believed to have a material impact on the Company's solvency.

## C.7 COVID-19 Risks

On 11 March 2020, the World Health Organisation declared a pandemic in relation to the outbreak of the COVID-19 virus. In particular, the following areas are exposed to increased risk as a result of the pandemic:

- Loss exposure and reserve adequacy;
- Responsiveness and recoverability of reinsurance contracts;
- Valuation of the investment portfolio;
- Recoverability of debtor balances; and
- Operational Risk

The Company's capital may therefore be negatively impacted by the COVID pandemic.

The Company has evaluated / addressed these risks as follows:

- Continuous review of COVID loss development and impact of the FCA court case;
- Performance and valuation review of the investment portfolio, particularly focused on any potential security defaults ;
- Consideration of any impact on recoverability of debt;
- Successful implementation of work from home environment and ability to bind business during the pandemic.

Throughout 2020 the COVID-19 pandemic has continued to develop leading to increased uncertainty in the market. The level of catastrophe exposure in respect of COVID-19 for the Company is considered material and continues to be monitored closely. To assess the impact on the Company's reserves, a detailed review of policy wording and exposure was performed by the actuarial team, in conjunction with the claims and underwriting teams.

Following the Supreme Court's final judgement on the FCA's business interruption test case, which substantially allowed the FCA's appeal on behalf of policy holders, the COVID-19 reserves held by the Company were reviewed in light of the updated court ruling and found to be appropriate. As the claims experience continues to develop, the reserves continue to be subject to ongoing review.

In addition to the reserve risk arising out of the COVID-19 pandemic, there is also an increased probability of further risks arising out of the COVID-19 pandemic. These risks include second order impacts on the economy, the insurance industry and individual classes of business, such as interest rate and currency volatility, increased risk of security defaults and an increased risk of inability to bind business.

As the Company continues to be closely currency matched, the exposure to currency volatility is significantly reduced, whilst the interest rate risk continues to be monitored in conjunction with the

investment manager. To date, no increase in security defaults have been observed or notified by the investment manager but the investment committee continues to monitor the performance of the Company's investment portfolio. Lastly, the transition to working fully digitally has been successful with the ability to successfully bind business not being impacted by the COVID-19 pandemic.

The operational risks to the Company arising out of the COVID-19 pandemic broadly fall within two categories:

- a) Maintaining the operating effectiveness of risk and control procedures;
- b) Ensuring safety and health of our staff whilst maintaining efficiency and effectiveness levels of staff working 100% remotely.

To ensure the operating effectiveness of the Company's risk and control procedures, the risk function performed an in-depth review of the risk and control procedures in conjunction with the business. The review focused on whether, and to what extent, business risks had changed as a result of the pandemic and whether the effectiveness of any controls would be compromised due to staff working 100% remotely. The review concluded that on the whole operational risk had not materially increased due to the pandemic and that the business was able to function broadly as prior to the COVID-19 outbreak. The impact on risk and controls continues to be monitored. During the early stages of the COVID-19 pandemic, a working from home policy was implemented across all UK staff and offices closed ahead of the government-mandated action. The policy continues to be revised to align with the latest government advice.

To enable a successful remote working environment, new IT initiatives were rolled out to facilitate better communication, positively impacting team collaboration whilst additional IT equipment was sourced to provide conducive home working environments.

In addition to practical initiatives to facilitate efficient working from home for all staff, a number of well-being initiatives have been launched during the last 12 months. This includes the Mental Health First Aider ("MHFA") team, who have provided support to all staff during the pandemic.

Whilst there have not been no reports of significant infection rates amongst the Company's staff, with limited impact on workforce productivity, infection rates continue to be monitored on an ongoing basis.

## **C.8 Part VII Transfer**

The UK's decision to leave the European Union resulted in significant uncertainties around the ability of UK-based insurers to write business in the European Union. Whilst a trade deal was finally agreed on 24 December 2020, the deal does not currently cover financial services. In particular the agreement does not provide passporting rights like those in the EU single market: UK and EU financial services will need local authorisation. EU-headquartered firms that relied on passport rights to engage with UK clients will have to rely on the UK's temporary permissions regime with a view to becoming FCA or PRA authorised, or cease to do business in the UK, or limit their activities to the terms of the UK's overseas person's exclusion. A UK firm doing business with EU clients will need to be authorised in an EU member state, or rely on exclusions, or temporary relief.

To manage the regulatory risk arising out of the Brexit vote, the Company elected to transfer its European business to Arch Insurance (EU) dac, a fellow entity owned by Arch Capital Group Ltd, and

domiciled in Ireland. The transfer was completed on 31 December 2020. Below, the current progress and key risks have been set out in further detail.

### **C.8.1 Current Progress**

To date, the following progress has been made:

- Transfer of all EEA non-life insurance policies written between 2003 and 2020 (and related liabilities) underwritten by the Company for those years of accounts were transferred to AIEU on 31 December 2020.
- IT solutions have been implemented ready for 2021 operational and reporting requirements.

### **C.8.2 Key Risks resulting from the Part VII Transfer**

The following risks have emerged specifically as a result of the Part VII transfer:

- Binding of EEA risks by AIUK (post 1 January 2021). This is being addressed through the use of system controls and automation to prevent underwriting teams writing EEA risks on UK paper.
- Accurate identification and separation of finance entries in Bank Accounts between AIUK and AIEU. This is being undertaken through use of IT solutions and development.
- Accurate policy identification within policy systems and the accurate reporting in downstream systems and the general ledger.

## **C.9 Emerging Risks**

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 potential material emerging threats to the Company. It is a core responsibility of each of our committees and we believe all reasonable steps are taken to minimise the likelihood and impact of potential emerging risks and to prepare for them in the event they occur. In particular, the Underwriting Committee, Investment Committee and Risk Committee have considered current emerging risks and the Emerging Risk Group (a sub-group of the Underwriting Committee) meets quarterly to discuss emerging risks with escalation to the Underwriting Committee. The Emerging Risk Group also partly reports into Arch Group's Emerging Risk Committee.

A number of emerging risks have been monitored over 2020 and reported to the Risk Committee including Brexit, climate change, COVID-19, LIBOR and operational resilience.

## **C.10 Any Other Information**

No other information to report as of 31 December 2020.

## SECTION D Valuation for Solvency Purpose

The table below shows the balance sheet as at 31 December 2020 on a FRS 102 basis, Solvency II basis and the adjustments to each line.

Details of the valuation changes are contained in the sections **D1 to D5**.

Balance Sheet as at 31 December 2020 - £'000s	UK GAAP	Adjustments	Solvency II
Deferred acquisition costs	42,804	(42,804)	- D1.8
Holdings in related undertakings, including participations	30,500	7,587	38,087 D1.2
Equities - unlisted	-	-	-
Government Bonds	35,595	114	35,709 D1.3
Corporate Bonds	20,413	84	20,497 D1.3
Collateralised securities	1,627	0	1,627 D1.3
Collective Investments Undertakings	19,288	0	19,288 D1.3
Reinsurance recoverables from: Non-life and health similar to non-life	531,602	(167,380)	364,222 D2
Insurance and intermediaries receivables	83,761	(73,231)	10,530 D1.4
Reinsurance receivables	13,131	(0)	13,131
Receivables (trade, not insurance)	40,197	117	40,314 D1.5
Cash and cash equivalents	12,401	0	12,401 D1.6
Any other assets, not elsewhere shown	14,386	(198)	14,188 D1.7
<b>Total assets</b>	<b>845,705</b>	<b>(275,711)</b>	<b>569,994</b>
Technical provisions - non-life	589,829	(158,373)	431,456 D2
Reinsurance payables	87,026	(87,026)	- D3.2
Payables (trade, not insurance)	12,300	-	12,300 D3.1
Subordinated liabilities	15,500	-	15,500 D4
Any other liabilities, not elsewhere shown	54,675	(35,866)	18,809 D3.1 / D3.3
<b>Total liabilities</b>	<b>759,330</b>	<b>(281,265)</b>	<b>478,065</b>
<b>Net Assets</b>	<b>86,375</b>	<b>5,554</b>	<b>91,929</b>

### D.1 Assets

The following are the bases, methods and main assumptions used for valuation of each material class of assets for Solvency II purposes.

#### D.1.1 Deferred tax assets

As at 31 December 2020, the Company has recognised £nil (2019: £nil) deferred tax assets being the temporary differences arising between the tax bases of assets and liabilities and their carrying amounts under Solvency II. Deferred tax assets are reviewed at each reporting date.

The measurement principles for deferred taxes are consistent between UK GAAP and Solvency II. Deferred tax assets are recognised to the extent that it is probable that future taxable profits will be available against which temporary differences can be utilised. The valuation difference relates to the change in the value of deferred tax, caused by the impact of adjustments made to balance sheet items in compliance with Solvency II regulations.

### **D.1.2 Holdings in related undertaking**

As at 31 December 2020, the Company valued its investment on its wholly owned subsidiary, AEIS, at £38.1 million (2019: £33.7 million) on a Solvency II basis. The valuation is based on adjusted equity method where the value of the investment is determined as the Company's share of AEIS' net assets. The value of AEIS comprises of a loan to AIGL and the remaining net assets of the entity excluding intangibles. The valuation of the adjusted equity method is consistent with Solvency II rules, where an intangible asset has been excluded from the net assets.

The value of the holdings in the related undertaking is different from the FRS 102 valuation, where the value was stated at the lower of cost less impairment or recoverable amount, which is £30.5 million.

In addition to the investment in its wholly owned subsidiary, the Company is party to a licensing agreement with AIGL permitting the Company to renew the UK commercial lines business acquired by AIGL from the Ardonagh Group in 2019.

The Company's subsidiary holds a £30.1 million (2019: £32.5 million) loan receivable, that was issued to AIGL to provide funding for the above-mentioned acquisition.

### **D.1.3 Investments (other than holding in related undertaking)**

As at 31 December 2020, the Company has a total of £77.1 million (2019: £74.0 million) investment assets that have been valued in accordance with FRS 102 fair value model. The Company's investments are externally managed. The Company receives quarterly reports detailing the underlying securities held in the investment funds. The quarterly reports are reviewed to ensure average credit ratings and durations have not moved significantly since the previous quarter. Any unusual movements or discrepancies are discussed with the fund managers. This information is presented to the Investment Committee every quarter.

The investments are valued at fair value under FRS 102 and Solvency II based on market prices at the reporting date, which are quoted prices in active markets for identical assets. The investments under Solvency II include accrued interest which under FRS 102 is reported under other assets.

The valuation of investments is consistent with the accounting valuation under FRS 102.

### **D.1.4 Insurance and intermediaries receivables**

Insurance and intermediaries receivables balance represents premiums owed from policyholders. As at 31 December 2020, the Company has a total of £10.5 million (2019: £26.3 million) of outstanding premiums. Outstanding premiums are valued at amortised cost as an approximation to fair value and due to the short-term nature of the receivable no adjustments to valuation are required. The valuation of insurance and intermediaries receivables is consistent with the FRS 102. The deferred premiums held under FRS 102 are transferred from insurance and intermediaries to the technical provisions in the calculation of the Solvency II balance sheet.

### **D.1.5 Reinsurance receivables**

The reinsurance receivables balance represents recoverables from reinsurers on settled claims. As at 31 December 2020, the Company has a total of £13.1 million (2019: £17.3 million) of reinsurance receivable. Reinsurance receivables are valued at amortised cost as an approximation to fair value and

due to the short-term nature of the receivable no adjustments to valuation are required. The valuation of reinsurance receivables is consistent with the accounting valuation under FRS 102.

#### **D.1.6 Cash and cash equivalents**

As at 31 December 2020, the Company has £12.4 million (2019: £30.3 million) held as cash and cash equivalents with £6.6 million (2019: £6.8 million) in the UK. The UK bank accounts are held in major currencies which are GBP, USD, EUR and AUD. The monies held in Germany, Italy and Spain bank accounts are denominated in EUR. The non-GBP balances are translated into GBP at the balance sheet closing rate.

There is no valuation difference between FRS102 and Solvency II for cash and cash equivalents.

#### **D.1.7 Other assets and non-insurance receivables**

Other assets and non-insurance receivables have been valued using the alternative valuation method in accordance with Solvency II. The Directors have used the cost approach or current replacement cost approach, being the closest to the fair value of these assets.

The valuation of other assets and non-insurance receivables is consistent with the accounting valuation under FRS 102.

#### **D.1.8 Deferred acquisition costs**

In the SFCR, acquisition costs, which represent commission and other related expenses, are deferred over the years in which the related premiums are earned. The deferred expenses relate to commissions, underwriter salaries, office costs, and marketing which are deferred based on a ratio between bound and quoted policies by line of business.

The Solvency II balance sheet is prepared on the basis that best estimate future cash flows on servicing (re)insurance contracts are included in the calculation of SII Technical Provisions. Therefore, deferred acquisition costs are excluded from the Solvency II balance sheet.

### **D.2 Technical Provisions**

#### **D.2.1 Results summary**

A summary of the technical provisions for the Company as at 31 December 2020 is set out below, split by material lines of business:

	<b>Net Best Estimate Claims Provision £'000</b>	<b>Net Best Estimate Premium Provision £'000</b>	<b>Risk Margin £'000</b>	<b>Net Technical Provisions £'000</b>	<b>% Of Net TP %</b>
Medical Expenses	(21)	-	-	(21)	0%
Income Protection	595	(879)	49	(235)	0%
Motor Vehicle Liability	-	(14)	1	(13)	0%
Other Motor	(776)	281	52	(443)	-1%
Marine, Aviation and Transport	3,958	1,431	532	5,921	9%
Fire and Other Damage to Property	16,123	6,058	1,694	23,875	35%
General Liability	29,638	4,714	3,258	37,610	56%
Non-Proportional Casualty	40	106	12	158	0%
Credit and suretyship insurance	108	244	30	382	1%
<b>Total</b>	<b>49,665</b>	<b>11,941</b>	<b>5,628</b>	<b>67,234</b>	<b>100%</b>

The total technical provisions are £67.4 million. This consists of £49.7 million in respect of the claims provision (earned business) and £11.9 million in respect of the premium provision (unearned business). A further £5.6 million is in respect of the risk margin.

The process of valuing AIUK's Technical Provisions ("TPs") begins with actuarial valuation of our FRS 102 basis reserves for loss and loss adjustment expenses ("Loss Reserves"). Cash flows associated with those Loss Reserves, along with unearned premium reserves and provisions for other components of TPs, are converted to an economic basis using the approach outlined below.

Technical provisions arising out of the COVID-19 pandemic in respect of premium provisions included in the table above amount to £5.3 million on a gross basis, and £0.6 million on a net basis.

## D.2.2 Calculation Methodology

Under Solvency II an economic balance sheet is required to be prepared – which involves inclusion of a market valuation of technical provisions. The overarching principle for valuing technical provisions under Solvency II is the current balance insurance undertakings would have to pay if they were to transfer their (re)insurance obligations immediately to another undertaking.

The calculations for the Solvency II technical provisions are based on the existing FRS 102 valuation, which in itself contain key sources of estimation uncertainty. 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.

### (i) Process used to determine the assumptions for measuring insurance contracts

Loss Reserves are established to provide for loss adjustment expenses and represent the estimated expense of settling claims, including legal and other fees and the general expenses of administering the claims adjustment process. Periodically, adjustments to the reported or case reserves may be

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

Ultimate losses and loss adjustment expenses are generally determined by extrapolation of claim emergence and settlement patterns observed in the past that can reasonably be expected to persist into the future. The 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 including COVID-19. 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.



The selection of a method to determine the Company's reserves is driven by not only the characteristics of the lines of business, but also by the development stage of the years of account and the availability, credibility and relevance (for future projection) of in-house or benchmark data. For short-tail lines of business, such as Property and Offshore Operating, reserves will mostly be calculated using the expected loss ratio method for the most recent year of account, unless early loss experience necessitates an upward deviation, before moving to the more data-driven methods for more mature years. For long-tail lines of business, typically the Casualty and D&O classes, reflecting slower loss emergence and settlement, the expected loss ratio method is usually applied for longer than 1 year, unless early loss experience necessitates an upward deviation, before allowing for benign claims experience using more data-driven methods.

We have reserved for losses arising from the COVID-19 pandemic by assessing the likely severity and frequency of policies potentially exposed. The assessment is more uncertain because it is a unique event. This assessment is reviewed at least quarterly. The majority of exposure arises from the UK business interruption classes of business.

To convert the reserves calculated under FRS 102 methodology set out above, the same methodology is applied to each homogeneous risk group and follows the steps laid out below:

- Gross and net best estimates are estimated separately for each underwriting year. Each underwriting year is then split into earned or unearned business. Relevant payment patterns are applied to these different blocks according to the respective state of their development. The outputs are gross and net outflows for claims payments, separately for claims provision and premium provision;
- Premiums receivable are derived from the analysis of debtor cash flows, i.e. looking at the not yet due debt collectables. Estimates of not yet due debt collectables are used directly as cash inflows. The output are gross cash inflows for premiums receivable for both the claims and premium provision. It is worth noting that debt due but not received is excluded from the technical provisions and is instead included within insurance receivables on the balance sheet. In addition, the calculations also allow for future reinsurance costs which correspond to recoveries being made in respect of claims;
- A number of adjustments are allowed for in the steps above:
  - The business contractually agreed before the balance sheet date, but incepting after the balance sheet date. This is referred to as Written But Not Incepted ("WBNI") business; and
  - Events Not In Data ("ENIDs"): Solvency II requires the Best Estimate to include allowance for "all possible outcomes", e.g. latent claims or extreme high severity, low probability claims. An ENID provision is calculated to allow for all possible scenarios where historical data may be lacking
  - Removal of margins: Removal of FRS103 prudent margins.
- Cash outflows for reinsurance premiums payable/net premiums receivable are based on gross cash flows to which net or ceded ratios are applied to both premiums and claims. These net /ceded ratios are based on the ratios derived in the FRS 102 reserve exercise and follow the principle of correspondence as set out in **Section D.2.6**;
- Different types of expenses (acquisition costs, unallocated loss adjustor expenses, and administration expenses) are projected and future cash flows are derived from this analysis. The output is expense cash outflows separately for claims provision and premium provision;
- An allowance for cash inflows stemming from ceded reinsurance income is also made;

- An adjustment is carried out to allow for reinsurance counterparty default. The output is cash outflows for reinsurance counterparty default, separately for claims provision and premium provision;
- The risk margin is calculated at a total level by running off the one-year SCR over future years and multiplying the cash flows by a cost of capital of 6% per annum as prescribed by Article 39 of the Commission Delegated Regulations (EU) 2015/35; and
- All future cash flow series above are discounted using payment patterns derived from the reserving process and the sum of these discounted cash flows is calculated for each series. These sums are then added together to derive the net best estimate liabilities. The discount rates used are those prescribed by EIOPA.

### Key Simplifications

The key simplifications made in the technical provision calculations are set out below:

- **Risk margin methodology** – Uses an approximation for the whole SCR for each future year, with a decayed run-off method. This method is used because a proportionate approach does not adequately capture the run-off, so a longer pattern is used to reflect relative reserve risk increasing as the size of the portfolio reduces; and
- **Calculation of recoverables** – as the timings of gross claim payments and corresponding recoveries are not markedly different, it is assumed that they correspond and projections use the timing of direct payments.

Whilst there are a number of limitations identified in the calculations of the technical provisions, there were no material uncertainties identified in the technical provisions process. All expert judgments are supported by relevant and appropriate data, and exercised by recognised experts within the Company.

### **D.2.3 Material Changes since Last Reporting Period**

The TPs as at 31 December 2020, include a removal of implicit margin, which was not removed in the 2019 TPs. The rationale for removing the implicit margin is to move from a Prudent Best Estimate (“PBE”) TP reserving methodology to a True Best Estimate (“TBE”) TP reserving methodology. Whilst the PBE presented in 2019 is still considered to be within the range of the best estimate TPs, and therefore, by definition constitutes a best estimate, the updated methodology provides more clarity and a TBE view of the TPs.

To quantify the implicit margin, standard market practice would be to equate the implicit margin to the margin over the Statement of Actuarial Opinion (“SAO”) reserves. The benefit of applying this approach is that the quantum of the implicit margin is based on estimations performed by an independent third party. The key draw-back of this approach is that the third party actuaries will be less familiar with the business, apply a more mechanical approach to reserving and would usually react quite significantly to large losses, which can result in an estimate that is too volatile to reflect in Solvency II Technical Provisions.

Therefore, instead of quantifying the implicit margin by equating it to the margin over the SAO, the Company has adopted a different approach. The Company’s reserving actuaries have completed a separate reserving exercise, which in comparison to the UK GAAP reserving process uses the same data, same level of information and the same personnel. However, rather than projecting a PBE, the actuaries project a TBE, a less conservative estimate, with a guiding principle that by reserving at that

level, favourable and unfavourable PYD would be expected with equal probability. Fixing as many variables as possible, i.e. data, detailed knowledge of the business and personnel, and only changing the level of prudence applied, the quantification of the implicit margin as the difference between the two approaches is considered to create a significantly more accurate result than using the margin over the SAO.

A comparison to the last reporting period is shown below of the technical provisions including risk margin.

	2020		2019	
	£'000	% of Total	£'000	% of Total
<b>Technical Provisions</b>				
Medical Expenses	(21)	0%	59	0%
Income Protection	(235)	0%	1,734	2%
Motor Vehicle Liability	(13)	0%	238	0%
Other Motor	(443)	-1%	644	1%
Marine, Aviation and Transport	5,921	9%	5,505	7%
Fire and Other Damage to Property	23,875	35%	18,254	24%
General Liability	37,610	56%	50,496	66%
Non-Proportional Casualty	158	0%	242	0%
Credit and suretyship insurance	382	1%	287	0%
<b>Total</b>	<b>67,234</b>	<b>100%</b>	<b>77,459</b>	<b>100%</b>

The decrease in technical provisions is largely driven by the removal of the implicit margin within the 2020 figures which has been offset by the increase due to COVID-19.

AIUK technical Provisions have been impacted by COVID and these explicit figures and information can be seen on Page 8 within the COVID-19 pandemic section.

#### D.2.4 Impact of Reinsurance

The held provisions for Solvency II correspond to the probability-weighted average of all future cash flows including cash flows recoverable from reinsurance contracts and special purpose vehicles. This takes account of the time value of money, using the relevant risk-free interest rate, and the adjustment for the expected losses due to the default of the counterparty (i.e. bad debt).

Recoverables from reinsurance contracts are shown separately on the asset side of the balance sheet (as "recoverables from reinsurance contracts"). Recoveries due on settled claims do not sit within the technical provisions, i.e. those where collection notes have been sent out but not received – reinsurance receivables.

Calculation of amounts recoverable from reinsurance contracts are performed under the same principles as for calculation of the gross best estimate. Risk margins are not required in respect of reinsurance and special purpose vehicle recoverables, as risk margins are calculated at a net level.

Gross and net best estimate reserves are estimated separately for each underwriting year. Reinsurance cash flows are then derived as the difference between gross and net cash flows.

Reserves are calculated on both gross and net (post internal quota share) bases. The net figures are produced in two stages:

- Firstly applying all external reinsurance; and

- Secondly applying the intercompany quota share (85% placement).

Cash inflows stemming from ceded reinsurance income are calculated as a factor of net premiums.

In addition, the principle of correspondence underlying the calculation of reinsurance recoveries is also considered.

#### **D.2.5 Pre-Intercompany Quota Share**

All cash flows which are calculated pre-intercompany quota share (i.e. after applying only the external reinsurance) are based on those in the net FRS 102 reserves. The calculations are consistent with net to gross ratios used in the FRS 102 reserving exercise (i.e. historical ratios), with different ratios applied to claims and premiums.

The pre-intercompany quota share cash flows are adjusted for the following:

- Ceded percentages of the quota share are applied for claims and premium cash flows. The ceded percentages are based on the actual percentages defined by the quota share; and
- Ceding commission cash flows are based on the ceded premium for the quota share. The cash flows are calculated by applying the current ceding commission percentage to the ceded premium amounts.

#### **Counterparty Default**

The expected loss due to the default of reinsurance counterparties is a small element within the technical provision calculations relating to bad debt. Reinsurance recoverables are calculated assuming no counterparty default. An adjustment for counterparty default is then explicitly calculated using S&P default rates and applied separately.

#### **D.2.6 Treatment of Future Premiums**

Future premiums, not yet due, are excluded explicitly from the Solvency II economic balance sheet and are instead included within the technical provisions. These premiums consist of four components:

- Premiums receivable for incepted policies included in the actuarial dataset
- Premiums receivable for incepted policies not included in the actuarial dataset ;
- WBNI premiums receivable; and
- Premiums receivable allowing for future reinsurance costs which relate to unearned business written to date.

Incepted future premiums included in the actuarial dataset are taken from aged debt reports which include splits of earned and unearned premiums. Where splits between earned and unearned premiums are unavailable, the uncertainty is addressed by applying average percentages instead. Future premiums receivable are not required to be fully allocated to premium provisions, as premium cash flows can also relate to earned business. These premiums are also allocated to underwriting years and lines of business based on the information in the aged debt reports.

Incepted future premiums not included in the actuarial dataset are taken from a financial data report showing the premiums written in the one month. WBNI premiums receivable are calculated using the WBNI uplift percentage against the expected annual premium as set out in the business plan for the

following year. The WBNI uplift percentage is an uncertain amount and is estimated using historical data analysis.

Ceded future premium is included as a direct input, rather than calculated using gross premiums and net to gross ratios. This is because premium receivable amounts do not necessarily correspond with premium payable balances. Within the economic balance sheet, an adjustment is also made for reinsurance balance payable not yet due. Without this adjustment, reinsurance liabilities would be double counted.

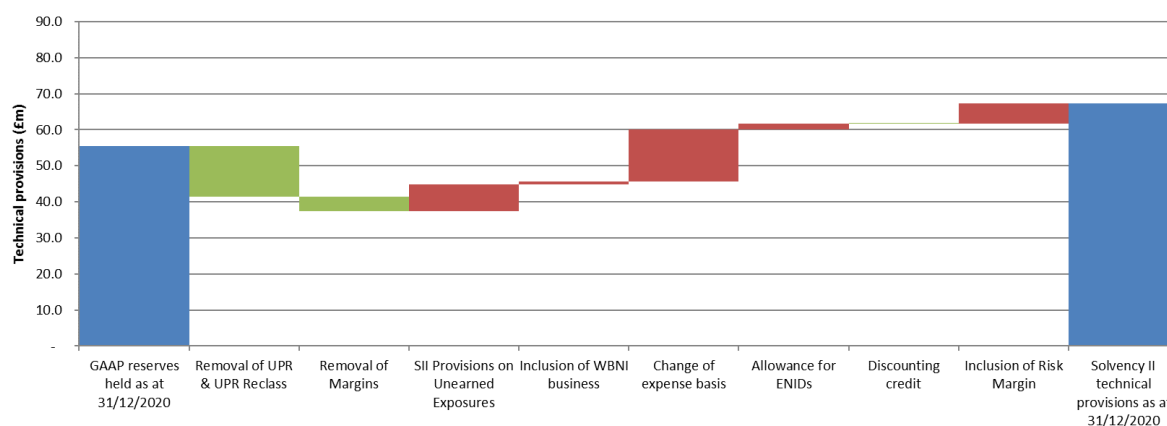
In addition, the principle of correspondence is considered when carrying out the calculation of reinsurance recoveries. When considering the contracts to be included, there should be correspondence between the gross inwards claims and the reinsurance recoveries included within the valuation. This includes the cost of future reinsurance cover not yet bought that will cover existing inwards contracts (e.g. losses occurring cover incepting in the following year). The additional reinsurance costs calculated for each line of business are allowed for by adjusting the ceded future premium amounts in respect of unearned business subject to minimum deposit premium terms per contract.

#### **D.2.7 Material Differences between FRS 102 and Solvency II**

Whilst some of the approaches and techniques applied under Solvency II are similar to those followed under the existing FRS 102 rules, there are other rules where there will be significant changes. These include:

- Movement to a cash flow basis for valuation of both gross business and reinsurance;
- Removal of any implicit or explicit margins within technical provisions to give a “true best estimate” for solvency purposes, defined as the mean of the full range of possible future outcomes;
- Introduction of the valuation of very low probability extreme events including latent claims, referred to as an allowance for “events not in data” or ENIDs;
- Removal of the requirements to hold an unearned premium reserve and to allow for other non-monetary items. These are replaced by “premium provisions”, valued on a best estimate basis. This also includes a requirement to take account of all future premium cash inflows;
- Movement to recognising contracts on a “legal obligation basis”. This will mean the inclusion of business currently not valued as part of technical provisions – for example 1 January renewals entered into prior to a 31 December valuation;
- Introduction of discounting of cash flows;
- Introduction of the principle of a market consistent basis and calculation of a “risk margin”; and
- Valuation of liabilities segmented by Solvency II lines of business.

The waterfall chart below sets out the movement analysis between FRS 102 and Solvency II for the Company as at 31 December 2020:



*Each of the above Solvency II adjustments are independent and discreet in the calculations.*

- (i) Removal of 100% UPR & UPR reclass (-£14.1 million).
- (ii) Removal of margins (-£3.9 million). This is removal of any implicit margin.
- (iii) Solvency II provisions on unearned exposures (+£7.3 million). An increase to the technical provisions due to the intercompany quota share element of claims payable from December 2020 included in technical provisions in addition to a small loss on future premiums.
- (iv) Inclusion of unaccepted business (+£0.8 million). An increase to the technical provisions which corresponds to a small loss on the WBNI business.
- (v) Change of expense basis (+£14.5 million). The adjustment reflects the additional expenses that would be incurred to service existing insurance liabilities.
- (vi) Allowance for ENIDs (+£1.5 million). A small increase to the technical provisions due to an allowance for events not in data.
- (vii) Discounting credit (£0.0 million). Application of risk free discount rates, which leads to a reduction in the technical provisions.
- (viii) Inclusion of risk margin (+£5.6 million). An amount equivalent to a theoretical level needed to transfer the obligations to another insurance undertaking.

## D.2.8 Assumptions and uncertainty

The most material sources of uncertainty arise from the FRS 102 calculation. The main assumptions used in the technical provisions other than those in the GAAP reserves include Events Not In Data (ENIDs) and Written But Not Incepted business (WBNI).

### Removal of Margins

See Section D2.3

### Events Not In Data

ENIDs are low frequency/high severity claims not captured in the data. We add an explicit amount, or load, to the calculations to take account of ENIDs. The ENID loadings for each line of business are derived using a truncated distribution approach. This methodology is based on the true mean of a reserve distribution being underestimated as it will only include information which is realistically foreseeable. If an assumption is made about the level at which events are realistically foreseeable then derived uplifts can be applied to estimate a mean allowing for incomplete information.

Using stochastic reserving techniques and appropriate fitting algorithms, we determine that the Company's best estimate reserves are log-normally distributed.

The calculated uplifts are then validated using expert judgement from the risk management and underwriting teams to ensure appropriateness of the assumptions. Uplifts can be adjusted based on this expert judgement, e.g. if there has been significant experience of tail events or relatively benign experience for a particular class of business.

We validate our selection by comparing them to benchmark market data and make adjustment if our selections are believed to be materially out of line with the market. In addition we perform sensitivity tests to gauge the materiality of this assumption. The current sensitivity test shows that removing the ENIDS would approximately reduce the TPs by 2.3%.

### **Written But Not Incepted business**

This relates to the business contractually agreed before the balance sheet date, but incepting after the balance sheet date. This is also referred to as unaccepted business. Unaccepted uplifts are calculated separately for each line of business using historical Company data. Historical policy data is used to calculate what the previous unaccepted uplifts have been for previous years.

The unaccepted business sensitivities are applied to understand the materiality of the assumptions and to validate the application of unaccepted business uplifts in the calculations. Removing the calculations for unaccepted business increases the premium provision by approximately 1%. This is because the unaccepted business is believed to be profitable.

## **D.3 Other Liabilities**

The following are the bases, methods and main assumptions used for valuation of each material class of other liabilities for Solvency II purpose.

### **D.3.1 Other liabilities and non-insurance payables**

Other liabilities and non-insurance payables have been valued using the alternative valuation method in accordance with Solvency II. The Directors have used the cost approach or current replacement cost approach, being the closest to the fair value of these assets.

The valuation of other assets and non-insurance receivables is consistent with the accounting valuation under FRS 102.

### **D.3.2 Reinsurance Payables**

Under Solvency II the reinsurance payables are transferred from the FRS 102 balance sheet and reported as part of the technical provisions. The reinsurance payables under Solvency II is reported as nil. (See section **D.2** for information on TPs)

### **D.3.3 Deferred ceded acquisition costs**

In the financial statements, ceded acquisition costs, which represent commission and other related expenses, are deferred over the years in which the related reinsurers' share of premiums are earned.

The Solvency II balance sheet is prepared based on the best estimate of future cash flow basis. Therefore, deferred ceded acquisition costs are being excluded from the Solvency II balance sheet.

### **D.4 Subordinated liabilities**

The subordinated liabilities are in respect of the subordinated loan between ACFI and AIUK. An additional loan valued at £7.5 million was entered into on 29 December 2020. The total subordinated liabilities are now £15.5 million (2019: £8.0 million). Under Solvency II subordinated liabilities are measured on a fair value basis whilst under FRS102 they are measured at amortised cost.

### **D.5 Alternative Methods of Valuation**

No alternative methods for valuation were used in 2020.

### **D.6 Any Other Information**

No other information to report as of 31 December 2020.



## SECTION E Capital Management

### Overview

The Company has adopted a capital management policy setting out the methodology and procedures to provide oversight of the Company's own funds. The strategic objectives articulated in the capital management policy are (i) to ensure compliance with the Company's regulatory capital requirements, (ii) to manage and allocate capital efficiently to achieve sustainable returns and facilitate growth objectives as articulated in the Company's business plans; and (iii) to ensure access to capital markets on competitive terms, so that the Company's overall cost of capital is minimised. To achieve these objectives, the Company strives to maintain capital levels that are consistent with its risk appetite, corporate strategy and statutory minimum requirements, at both a point in time and on a forward looking basis. The Company's time horizon for business planning is one year, however the capital planning horizon spans three years.

The Company has adopted a capital management plan which is reviewed annually and sets out the methodology and procedures to provide oversight of the Company's own funds. The capital management plan articulates solvency capital thresholds, corrective actions to be taken if the thresholds are breached and potential sources of capital for the Company and their estimated timeframe of realisation.

High level roles and responsibilities in relation to capital management activities are outlined below.

- **Board:** Sole responsibility for approving the capital management policy and plan. Overall responsibility for monitoring capital management;
- **Risk Committee:** Reviews the capital management policy and makes recommendations to the Board. Responsible for reviewing and monitoring the key capital management metrics and tolerances and presenting key capital management information to the Board on an ongoing basis;
- **Investment Committee:** Responsible for aligning the investment strategy with the capital management policy and plan, and ensuring an appropriate level of funds are available to meet the Company's obligations in a timely manner and at a reasonable cost;
- **Finance Function:** Responsible for producing the reports necessary for appropriate monitoring that the capital management policy is being followed and monitoring execution of the capital management plan; and
- **Risk Management Function:** Responsible for maintaining the internal capital models and Standard Formula calculation, which amongst other uses, produce the economic and solvency capital requirements for AIUK.

In the event that the ongoing monitoring indicates that Company's capital position is outside of risk appetite, corrective actions shall, as deemed appropriate, be taken. Proposed corrective actions shall be initiated by the Finance function, after receiving approval from the Board on the appropriate corrective action to be taken. In the event that the Company's capital is below the SCR, the Company will communicate to the PRA immediately together with a proposed remediation plan.

The Company has identified management actions which would provide capital relief if required:

- Restricting line sizes / product redesign / repricing; and
- Discontinue / Run-off certain lines of business.

Estimated timeframe for realisation of relief from the management actions is six months.

Other potential sources of capital which the Company has identified are:

- Additional capital sourced from ACGL Group through contributed capital, capital loan or additional reinsurance arrangements;
- Purchasing external reinsurance;
- Changing mix to less capital intensive lines of business;
- Merging with cash rich partner;
- Sale of business / blocks of business; and
- Management buyout by current management team with corporate finance support to raise new third party capital.

Estimated timeframe for realisation of relief from the potential sources of capital from the Group is one month. Estimated timeframe for realisation of relief from outside parties is three months to one year.

It should be noted that the estimated timeframes above would be expected to be longer in a stressed scenario. The provision of additional capital by ACGL and capital relief by means of intragroup reinsurance is not guaranteed. The current quota share contract provides for a continuous contract terminable on 12 months' notice. As notice is customarily given to ensure that the terms of the reinsurance are agreed on a commercial and arm's length basis, it has been agreed that the Company may exercise an option to extend the period of the reinsurance by one year in the event of unsuccessful renegotiation, in order to enable an orderly transition to alternative funding.

During 2020 the definition of the economic capital requirement continued to use "adjusted net assets basis" using the Standard Formula SCR, in line with the commentary in Section E.1. Previously in 2018 economic capital requirements were based on a tail value at risk calculation using the internal model ultimate SCR.

The "adjusted net asset basis" is an additional, internally applied, more prudent measure, that the Board use to monitor solvency, and is not part of the requirement of Solvency II. It is reviewed as part of the Company's internal governance processes, but is unaudited.

## E.1 Own Funds

The Company's own funds are summarised in the table below:

	Tier 1	Tier 2	Tier 3	2020 Total Own Funds	2020 Adjusted net asset Approach *	2019 Total Own Funds	2019 Adjusted net asset Approach *
	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Paid-In Ordinary Share Capital	50,000	-	-	50,000	50,000	50,000	50,000
Other capital contribution	57,500	-	-	57,500	26,500	42,500	12,500
Reconciliation Reserve	(15,571)	-	-	(15,571)	(15,571)	(16,782)	(16,782)
Subordinated liabilities	-	15,500	-	15,500	15,500	8,000	8,000
<b>Total Own Funds After Deductions</b>	<b>91,929</b>	<b>15,500</b>	<b>-</b>	<b>107,429</b>	<b>76,429</b>	<b>83,718</b>	<b>53,718</b>
Total Eligible Own Funds to Meet the SCR				107,429	76,429	83,718	53,718
Total Eligible Own Funds to Meet the MCR				94,127	60,929	78,058	48,058
SCR				38,353	34,372	46,792	43,759
MCR				10,993	10,993	11,698	10,940
<b>Ratio of Eligible Own Funds to SCR</b>				<b>280.1%</b>	<b>222.4%</b>	<b>178.9%</b>	<b>122.8%</b>
<b>Ratio of Eligible Own Funds to MCR</b>				<b>856.2%</b>	<b>554.2%</b>	<b>667.3%</b>	<b>439.3%</b>

\* The "adjusted net asset basis" is reviewed as part of the Company's internal governance processes, but is not independently audited.

**Tier 1** capital is made up of £50.0 million issued and fully paid up ordinary shares, a loss of £15.6 million in the reconciliation reserve which is comprised of the excess of assets over liabilities on a Solvency II valuation basis, less other basic own fund items (see table on page 75 for valuation differences) between UK GAAP and Solvency II and £57.5 million other capital contribution. The Company had an existing capital contribution of £42.5 million and in 2020 the Company received £15.0 million capital contribution from its parent company, ARE to support the continued growth following the UK Regional acquisition, bringing the total additional capital contribution to £57.5 million which has increased the level of Tier 1 capital.

**Tier 2** capital is made of £15.5 million subordinated loan, including a loan of £7.5 million received in 2020 from ACFI, to support growth from the new UK Regional business.

### "Adjusted net asset basis (unaudited)"

Although the Company uses the Standard Formula for Solvency II in determining its regulatory capital, it does have an Internal Capital Model that it has previously used for setting economic capital and continues to use for a number of other purposes. Following the acquisition of UK regional business previously in 2019, the economic capital definition was revised to an "adjusted net asset basis" to ensure that the solvency position is adequately taking into account the Company's current capital structure. The purpose of this "adjusted net asset basis", using the standard formula as the starting point, is to recognise a solvency position where the underlying intangible assets held in respect of the acquisition in a fellow ACGL group company are treated as intangible assets on a look through basis, thereby reducing the value of own funds accordingly and also reducing the SCR relating to the market risk of these assets.

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.

Under the "adjusted net asset basis", the Company's own funds available is £76.4 million as at December 2020 against the SCR of £34.4 million, with a surplus of £42.0 million or 222.4%. The "adjusted net asset basis" excludes the loan balance with Arch Intermediaries Group Ltd ("AIGL"), formerly known as Arch (UK) Holdings Limited, within the available own funds and the SCR excludes the equity invested as part of UK Regional acquisition.

The Company remains above the target risk appetite of 120.0% against SCR on an "adjusted net asset basis".

The "adjusted net asset basis" is an additional, internally applied, more prudent measure, that the Board use to monitor solvency, and is not part of the requirement of Solvency II. It is reviewed as part of the Company's internal governance processes, but is unaudited.

On an adjusted net asset basis, the economic surplus has increased during 2020 due to additional capital contributions and subordinated debt in the year, which has been offset by financial year losses. The other components of own funds are unchanged.

There are no foreseeable dividend distributions by the Company.

The Expected Profit In Future premiums ("EPIFP") calculated gross of reinsurance is £13.5 million at 31 December 2020 compared to £6.6 million at 31 December 2019

**The table below shows the attribution of the Reconciliation Reserve:**

	<b>2020</b>
<b>Excess of Assets Over Liabilities - Attribution of Valuation Differences</b>	<b>£'000</b>
Total of Reserves and Retained Earnings from Financial Statements	(21,125)
Difference in the Valuation of Assets	(275,711)
Difference in the Valuation of Technical Provisions	158,373
Difference in the Valuation of Other Liabilities	122,892
<b>Reconciliation Reserve</b>	<b>(15,571)</b>

#### Reconciliation between FRS 102 and Solvency II Excess of Assets over Liabilities

The Company's financial statements are prepared in accordance with FRS 102.

The key differences between the net assets under FRS 102 and the excess of assets over liabilities under Solvency II are summarised in the table below:

	<b>2020</b>
	<b>£'000</b>
<b>Net Assets per Financial Statements in Accordance with UK GAAP</b>	<b>86,375</b>
Valuation Difference on Technical Provision	(2,033)
Valuation Difference on Investment in Subsidiary	7,587
Subordinated loan	15,500
<b>Total Own Funds Under Solvency II</b>	<b>107,429</b>

## E.2 Solvency Capital Requirement and Minimum Capital Requirement

In respect of the calculation of the SCR and MCR:

- The Company uses the Standard Formula;
- Undertaking specific parameters are not used;
- No capital add-ons are applied to the SCR figures;
- The simplifications outlined in Articles 107, 108, 110, 111 and 112 of the Commission Delegated Regulation (EU) 2015/35 apply to the counterparty default risk sub-module;
- Simplifications have been used in the market, counterparty and underwriting risk sub-modules, the simplifications included are as follows;
  - Interest Rate Risk on assets has been calculated using accumulated cash flows at currency level rather than individual asset level.
  - Counterparty default risk in line with Article 107 of the Delegated Acts, AIUK has applied the simplification for Risk Mitigating Effects of reinsurance to simplify the calculation and inputs required for the calculation. This derives a Gross underwriting Risk SCR from which the Net Underwriting Risk SCR is deducted to estimate the allowance of reinsurance on the SCR. This amount is then apportioned across the current reinsurance exposures in line with the outstanding recoverables.
  - Non-life underwriting risk within the Delegated Acts allow for a 20% reduction in the premium risk standard deviation for Fire and Property, General Liability and proportional classes due to XOL recoveries. It has assumed this reduction applies in all classes. AIUK does not capture sum insureds of EU countries by CRESTA zone as per the Delegated Acts. The additional diversification benefit is not deemed to be sufficiently material to warrant the significantly more detailed input requirements.
- The MCR is initially based on the calculation of the Linear MCR using the best estimate technical provisions and the net written premiums in the last 12 months. Then a floor of 25% of the SCR and a cap of 45% of the SCR is applied with an absolute floor of £3.3 million also applied to derive the final MCR requirement; and
- The Company has no material exposure to equity, hence the duration-based equity risk sub-module is not used.

As at 31 December 2020, the SCR is £38.4 million and the MCR is £10.9 million. A breakdown of SCR by risk category is set out in the following table:

There has been no material change to the Company's SCR and MCR during 2020, other than the Part VII transfer to AIEU from 31 December 2020. Further details of this is set out on page 5.

<b>Risk category</b>	<b>£'000</b>
Insurance risk	22,969
Market risk	9,262
Credit risk	5,296
<b>Undiversified Basic SCR</b>	<b>37,527</b>
Diversification credit	(8,025)
<b>Basic SCR</b>	<b>29,502</b>
Operational risk	8,851
<b>SCR</b>	<b>38,353</b>

### **E.2.1 SCR ratio and MCR ratio**

As at 31 December 2020, the ratio of eligible own funds to SCR is 280.1% (2019: 178.9%) and the ratio of eligible own funds to MCR is 856.2% (2019: 667.3%) on a standard Solvency II basis.

The Company uses the Standard Formula for determining its regulatory capital and also uses the Standard Formula on an “adjusted net asset basis” for setting economic capital. Under the “adjusted net asset basis”, the Company’s own funds available is £76.4 million as at December 2020 against the SCR of £34.4 million, with a surplus of £42.0 million or 222.4%.

The Company complied with the Solvency Capital Requirement and Minimum Capital Requirement during 2020.

### **E.3 Use Of The Duration-Based Equity Risk Sub-Module In The Calculation Of The SCR**

The duration-based equity risk sub-module is not used in the calculation of the SCR.

### **E.4 Differences Between The Standard Formula And Any Internal Model Used**

Only the standard formula was used in the calculation of the SCR.

### **E.5 Non-Compliance With The MCR and Non-Compliance With The SCR**

The Company complied with the SCR and MCR during 2020 and as at the date of this report.

### **E.6 Any other information**

#### **Brexit Plans**

Please refer to Summary and Section A1.7

#### **Climate Change**

Please refer to Section A1.7

#### **COVID-19**

Please refer to Summary and Section A1.7

#### **AIUK to AIEU Part VII Transfer**

Please refer to Summary and Section A1.7

## Appendix 1

## ACGL Organisational Structure

Date: 12/31/2020



**Key:** For each entity, the company name (jurisdiction), FEIN # (where applicable) and NAIC # (or equivalent number if applicable) are listed





# Arch Insurance (UK) Limited

## Solvency and Financial Condition Report

### Disclosures

31 December  
**2020**

(Monetary amounts in GBP thousands)

## General information

Undertaking name	Arch Insurance (UK) Limited
Undertaking identification code	213800GLG1B1FI4VN881
Type of code of undertaking	LEI
Type of undertaking	Non-life undertakings
Country of authorisation	GB
Language of reporting	en
Reporting reference date	31 December 2020
Currency used for reporting	GBP
Accounting standards	Local GAAP
Method of Calculation of the SCR	Standard formula
Matching adjustment	No use of matching adjustment
Volatility adjustment	No use of volatility adjustment
Transitional measure on the risk-free interest rate	No use of transitional measure on the risk-free interest rate
Transitional measure on technical provisions	No use of transitional measure on technical provisions

## List of reported templates

S.02.01.02 - Balance sheet  
S.05.01.02 - Premiums, claims and expenses by line of business  
S.05.02.01 - Premiums, claims and expenses by country  
S.17.01.02 - Non-Life Technical Provisions  
S.19.01.21 - Non-Life insurance claims  
S.23.01.01 - Own Funds  
S.25.01.21 - Solvency Capital Requirement - for undertakings on Standard Formula  
S.28.01.01 - Minimum Capital Requirement - Only life or only non-life insurance or reinsurance activity

## S.02.01.02

### Balance sheet

Solvency II value	
C0010	
	0
	115,208
	0
	38,087
	0
	57,833
	35,709
	20,497
	0
	1,627
	19,288
	0
	0
	0
	0
	364,222
	364,222
	359,706
	4,516
	0
	0
	10,530
	13,131
	40,314
	0
	12,401
	14,188
	569,994

#### Assets

R0030	Intangible assets
R0040	Deferred tax assets
R0050	Pension benefit surplus
R0060	Property, plant & equipment held for own use
R0070	Investments (other than assets held for index-linked and unit-linked contracts)
R0080	<i>Property (other than for own use)</i>
R0090	<i>Holdings in related undertakings, including participations</i>
R0100	<i>Equities</i>
R0110	<i>Equities - listed</i>
R0120	<i>Equities - unlisted</i>
R0130	<i>Bonds</i>
R0140	<i>Government Bonds</i>
R0150	<i>Corporate Bonds</i>
R0160	<i>Structured notes</i>
R0170	<i>Collateralised securities</i>
R0180	<i>Collective Investments Undertakings</i>
R0190	<i>Derivatives</i>
R0200	<i>Deposits other than cash equivalents</i>
R0210	<i>Other investments</i>
R0220	Assets held for index-linked and unit-linked contracts
R0230	Loans and mortgages
R0240	<i>Loans on policies</i>
R0250	<i>Loans and mortgages to individuals</i>
R0260	<i>Other loans and mortgages</i>
R0270	Reinsurance recoverables from:
R0280	<i>Non-life and health similar to non-life</i>
R0290	<i>Non-life excluding health</i>
R0300	<i>Health similar to non-life</i>
R0310	<i>Life and health similar to life, excluding index-linked and unit-linked</i>
R0320	<i>Health similar to life</i>
R0330	<i>Life excluding health and index-linked and unit-linked</i>
R0340	<i>Life index-linked and unit-linked</i>
R0350	Deposits to cedants
R0360	Insurance and intermediaries receivables
R0370	Reinsurance receivables
R0380	Receivables (trade, not insurance)
R0390	Own shares (held directly)
R0400	Amounts due in respect of own fund items or initial fund called up but not yet paid in
R0410	Cash and cash equivalents
R0420	Any other assets, not elsewhere shown
R0500	<b>Total assets</b>

## S.02.01.02

### Balance sheet

		Solvency II value
		C0010
<b>Liabilities</b>		
R0510	Technical provisions - non-life	431,456
R0520	<i>Technical provisions - non-life (excluding health)</i>	427,196
R0530	<i>TP calculated as a whole</i>	0
R0540	<i>Best Estimate</i>	421,618
R0550	<i>Risk margin</i>	5,579
R0560	<i>Technical provisions - health (similar to non-life)</i>	4,260
R0570	<i>TP calculated as a whole</i>	0
R0580	<i>Best Estimate</i>	4,211
R0590	<i>Risk margin</i>	49
R0600	Technical provisions - life (excluding index-linked and unit-linked)	0
R0610	<i>Technical provisions - health (similar to life)</i>	0
R0620	<i>TP calculated as a whole</i>	
R0630	<i>Best Estimate</i>	
R0640	<i>Risk margin</i>	
R0650	<i>Technical provisions - life (excluding health and index-linked and unit-linked)</i>	0
R0660	<i>TP calculated as a whole</i>	
R0670	<i>Best Estimate</i>	
R0680	<i>Risk margin</i>	
R0690	Technical provisions - index-linked and unit-linked	0
R0700	<i>TP calculated as a whole</i>	
R0710	<i>Best Estimate</i>	
R0720	<i>Risk margin</i>	
R0740	Contingent liabilities	0
R0750	Provisions other than technical provisions	
R0760	Pension benefit obligations	
R0770	Deposits from reinsurers	
R0780	Deferred tax liabilities	
R0790	Derivatives	
R0800	Debts owed to credit institutions	
R0810	Financial liabilities other than debts owed to credit institutions	
R0820	Insurance & intermediaries payables	
R0830	Reinsurance payables	0
R0840	Payables (trade, not insurance)	12,300
R0850	Subordinated liabilities	15,500
R0860	<i>Subordinated liabilities not in BOF</i>	
R0870	<i>Subordinated liabilities in BOF</i>	15,500
R0880	Any other liabilities, not elsewhere shown	18,809
R0900	<b>Total liabilities</b>	478,065
R1000	<b>Excess of assets over liabilities</b>	91,929

S.05.01.02

Premiums, claims and expenses by line of business

Non-life

Line of Business for: non-life insurance and reinsurance obligations (direct business and accepted proportional reinsurance)												Line of business for: accepted non-proportional reinsurance				Total
Medical expense insurance	Income protection insurance	Workers' compensation insurance	Motor vehicle liability insurance	Other motor insurance	Marine, aviation and transport insurance	Fire and other damage to property insurance	General liability insurance	Credit and suretyship insurance	Legal expenses insurance	Assistance	Misc. financial loss	Health	Casualty	Marine, aviation and transport	Property	
C0010	C0020	C0030	C0040	C0050	C0060	C0070	C0080	C0090	C0100	C0110	C0120	C0130	C0140	C0150	C0160	C0200
<b>Premiums written</b>																
R0110	Gross - Direct Business	2,870	7,678		7,984	1,884	42,119	163,761	121,865	9,392						357,553
R0120	Gross - Proportional reinsurance accepted															0
R0130	Gross - Non-proportional reinsurance accepted												10			10
R0140	Reinsurers' share	2,442	6,530		6,918	1,629	36,483	145,880	107,051	9,127			9			316,068
R0200	Net	429	1,148		1,066	255	5,637	17,880	14,814	265			2			41,495
<b>Premiums earned</b>																
R0210	Gross - Direct Business	1,226	7,481		6,724	1,588	27,434	151,074	124,679	2,417						322,624
R0220	Gross - Proportional reinsurance accepted															0
R0230	Gross - Non-proportional reinsurance accepted												26			26
R0240	Reinsurers' share	1,044	6,360		5,828	1,371	23,608	134,794	109,494	2,403			22			284,923
R0300	Net	182	1,122		896	217	3,826	16,280	15,186	15			4			37,727
<b>Claims incurred</b>																
R0310	Gross - Direct Business	-488	3,633		1,230	3,574	12,643	113,687	78,427	-541						212,166
R0320	Gross - Proportional reinsurance accepted															0
R0330	Gross - Non-proportional reinsurance accepted												-127			-127
R0340	Reinsurers' share	-456	2,911		1,099	3,123	11,247	102,769	67,653	-411			-125			187,811
R0400	Net	-32	722		131	451	1,396	10,918	10,774	-130			-2			24,227
<b>Changes in other technical provisions</b>																
R0410	Gross - Direct Business	0	0		0	0	0	0	0							0
R0420	Gross - Proportional reinsurance accepted															0
R0430	Gross - Non-proportional reinsurance accepted												0			0
R0440	Reinsurers' share	0	0		0	0	0	0	0				0			0
R0500	Net	0	0		0	0	0	0	0				0			0
R0550	Expenses incurred	-40	-190		657	163	1,412	8,755	11,359	223			10			22,349
R1200	Other expenses															
R1300	Total expenses															22,349

## S.05.02.01

## Premiums, claims and expenses by country

## Non-life

R0010

C0010	C0020	C0030	C0040	C0050	C0060	C0070
Home Country	Top 5 countries (by amount of gross premiums written) - non-life obligations			Top 5 countries (by amount of gross premiums written) - non-life obligations		Total Top 5 and home country
	US	ZW	NO	CL	GH	
C0080	C0090	C0100	C0110	C0120	C0130	C0140

## Premiums written

R0110	Gross - Direct Business	272,497	14,690	4,078	3,327	3,180	2,576	300,348
R0120	Gross - Proportional reinsurance accepted	0	0	0	0	0	0	0
R0130	Gross - Non-proportional reinsurance accepted	0	0	0	0	0	0	0
R0140	Reinsurers' share	239,598	13,072	3,791	2,964	2,833	2,387	264,645
R0200	Net	32,898	1,618	287	363	347	189	35,703

## Premiums earned

R0210	Gross - Direct Business	250,432	13,570	2,463	3,070	2,934	1,622	274,090
R0220	Gross - Proportional reinsurance accepted	0	0	0	0	0	0	0
R0230	Gross - Non-proportional reinsurance accepted	0	0	0	0	0	0	0
R0240	Reinsurers' share	220,345	12,093	2,249	2,739	2,618	1,477	241,521
R0300	Net	30,087	1,477	214	331	316	145	32,570

## Claims incurred

R0310	Gross - Direct Business	161,132	10,121	1,363	2,310	2,208	935	178,069
R0320	Gross - Proportional reinsurance accepted	0	0	0	0	0	0	0
R0330	Gross - Non-proportional reinsurance accepted	0	0	0	0	0	0	0
R0340	Reinsurers' share	141,877	9,132	1,248	2,088	1,996	855	157,197
R0400	Net	19,254	989	115	222	212	80	20,872

## Changes in other technical provisions

R0410	Gross - Direct Business	0	0	0	0	0	0	0
R0420	Gross - Proportional reinsurance accepted	0	0	0	0	0	0	0
R0430	Gross - Non-proportional reinsurance accepted	0	0	0	0	0	0	0
R0440	Reinsurers' share	0	0	0	0	0	0	0
R0500	Net	0	0	0	0	0	0	0

R0550	Expenses incurred	18,171	758	160	178	170	104	19,541
R1200	Other expenses							
R1300	Total expenses							19,541

## Non-Life Technical Provisions

		Direct business and accepted proportional reinsurance											Accepted non-proportional reinsurance				Total Non-Life obligation	
		Medical expense insurance	Income protection insurance	Workers' compensation insurance	Motor vehicle liability insurance	Other motor insurance	Marine, aviation and transport insurance	Fire and other damage to property insurance	General liability insurance	Credit and suretyship insurance	Legal expenses insurance	Assistance	Miscellaneous financial loss	Non-proportional health reinsurance	Non-proportional casualty reinsurance	Non-proportional marine, aviation and transport reinsurance		Non-proportional property reinsurance
		C0020	C0030	C0040	C0050	C0060	C0070	C0080	C0090	C0100	C0110	C0120	C0130	C0140	C0150	C0160		C0170
R0010	Technical provisions calculated as a whole	0	0		0	0	0	0	0	0					0			0
R0050	Total Recoverables from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default associated to TP calculated as a whole																	0
Technical provisions calculated as a sum of BE and RM																		
Best estimate																		
Premium provisions																		
R0060	Gross	0	2,282		-19	1,737	5,130	18,447	39,641	5,555					552			73,327
R0140	Total recoverable from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default	0	3,161		-5	1,457	3,699	12,389	34,928	5,310					446			61,385
R0150	Net Best Estimate of Premium Provisions	0	-879		-14	281	1,431	6,058	4,714	245					106			11,942
Claims provisions																		
R0160	Gross	-147	2,076		0	-8,304	25,978	142,652	188,549	1,506					193			352,501
R0240	Total recoverable from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default	-126	1,481		0	-7,528	22,020	126,529	158,911	1,397					152			302,837
R0250	Net Best Estimate of Claims Provisions	-21	595		0	-776	3,958	16,123	29,638	108					40			49,665
R0260	Total best estimate - gross	-147	4,358		-19	-6,566	31,108	161,099	228,190	7,061					745			425,828
R0270	Total best estimate - net	-21	-284		-14	-495	5,389	22,181	34,352	353					147			61,606
R0280	Risk margin	0	49		1	52	532	1,694	3,258	30					12			5,628
Amount of the transitional on Technical Provisions																		
R0290	Technical Provisions calculated as a whole																	0
R0300	Best estimate																	0
R0310	Risk margin																	0
R0320	Technical provisions - total	-147	4,407		-18	-6,515	31,640	162,793	231,448	7,091					757			431,456
R0330	Recoverable from reinsurance contract/SPV and Finite Re after the adjustment for expected losses due to counterparty default - total	-126	4,642		-5	-6,071	25,720	138,918	193,839	6,708					598			364,222
R0340	Technical provisions minus recoverables from reinsurance/SPV and Finite Re - total	-21	-235		-14	-443	5,921	23,875	37,610	383					159			67,234



## S.19.01.21

## Non-Life insurance claims

## Total Non-life business

Z0020 Accident year / underwriting year Underwriting Year

## Gross Claims Paid (non-cumulative)

(absolute amount)

		C0010	C0020	C0030	C0040	C0050	C0060	C0070	C0080	C0090	C0100	C0110	C0170	C0180
	Year	Development year											In Current year	Sum of years (cumulative)
		0	1	2	3	4	5	6	7	8	9	10 & +		
R0100	Prior											16,569	16,569	16,569
R0160	2011	1,502	5,155	23,902	14,411	5,193	3,532	9,913	226	4,414	19,753		19,753	88,001
R0170	2012	248	6,329	36,113	9,964	5,560	10,273	8,406	3,318	25,153			25,153	105,362
R0180	2013	1,115	6,161	11,276	11,236	3,297	807	862	12,022				12,022	46,776
R0190	2014	975	16,030	20,184	15,571	2,345		13,971					13,971	70,173
R0200	2015	2,264	15,700	12,499	9,691		26,165						26,165	71,864
R0210	2016	2,916	21,132	13,469	14,461	24,690							24,690	76,667
R0220	2017	2,213	16,577	13,326	46,944								46,944	79,059
R0230	2018	1,946	22,132	42,670									42,670	66,748
R0240	2019	6,192	49,017										49,017	55,209
R0250	2020	8,204											8,204	8,204
R0260													Total	285,159
														684,634

## Gross Undiscounted Best Estimate Claims Provisions

(absolute amount)

		C0200	C0210	C0220	C0230	C0240	C0250	C0260	C0270	C0280	C0290	C0300	C0360
	Year	Development year											Year end (discounted data)
		0	1	2	3	4	5	6	7	8	9	10 & +	
R0100	Prior											24,752	24,753
R0160	2011	0	0	0	0	0	37,083	24,337	17,532	9,871	4,840		4,840
R0170	2012	0	0	0	0	44,286	36,824	24,504	21,690	21,280			21,284
R0180	2013	0	0	0	33,122	25,391	17,208	15,459	6,747				6,747
R0190	2014	0	0	49,081	34,269	26,588	16,744	13,714					13,745
R0200	2015	0	49,915	50,132	38,933	29,370	12,131						12,124
R0210	2016	29,703	54,279	41,087	30,063	25,002							25,007
R0220	2017	42,853	75,810	66,750	35,950								35,956
R0230	2018	39,042	70,885	41,604									41,632
R0240	2019	60,979	130,077										129,976
R0250	2020	36,592											36,437
R0260													Total
													352,501

# S.23.01.01

## Own Funds

Basic own funds before deduction for participations in other financial sector as foreseen in article 68 of Delegated Regulation 2015/35

R0010	Ordinary share capital (gross of own shares)
R0030	Share premium account related to ordinary share capital
R0040	Initial funds, members' contributions or the equivalent basic own-fund item for mutual and mutual-type undertakings
R0050	Subordinated mutual member accounts
R0070	Surplus funds
R0090	Preference shares
R0110	Share premium account related to preference shares
R0130	Reconciliation reserve
R0140	Subordinated liabilities
R0160	An amount equal to the value of net deferred tax assets
R0180	Other own fund items approved by the supervisory authority as basic own funds not specified above
R0220	Own funds from the financial statements that should not be represented by the reconciliation reserve and do not meet the criteria to be classified as Solvency II own funds
R0230	Deductions for participations in financial and credit institutions
R0290	Total basic own funds after deductions

### Ancillary own funds

R0300	Unpaid and uncalled ordinary share capital callable on demand
R0310	Unpaid and uncalled initial funds, members' contributions or the equivalent basic own fund item for mutual and mutual - type undertakings, callable on demand
R0320	Unpaid and uncalled preference shares callable on demand
R0330	A legally binding commitment to subscribe and pay for subordinated liabilities on demand
R0340	Letters of credit and guarantees under Article 96(2) of the Directive 2009/138/EC
R0350	Letters of credit and guarantees other than under Article 96(2) of the Directive 2009/138/EC
R0360	Supplementary members calls under first subparagraph of Article 96(3) of the Directive 2009/138/EC
R0370	Supplementary members calls - other than under first subparagraph of Article 96(3) of the Directive 2009/138/EC
R0390	Other ancillary own funds
R0400	Total ancillary own funds

### Available and eligible own funds

R0500	Total available own funds to meet the SCR
R0510	Total available own funds to meet the MCR
R0540	Total eligible own funds to meet the SCR
R0550	Total eligible own funds to meet the MCR

### R0580 SCR

### R0600 MCR

### R0620 Ratio of Eligible own funds to SCR

### R0640 Ratio of Eligible own funds to MCR

### Reconciliation reserve

R0700	Excess of assets over liabilities
R0710	Own shares (held directly and indirectly)
R0720	Foreseeable dividends, distributions and charges
R0730	Other basic own fund items
R0740	Adjustment for restricted own fund items in respect of matching adjustment portfolios and ring fenced funds
R0760	Reconciliation reserve

### Expected profits

R0770	Expected profits included in future premiums (EPIFP) - Life business
R0780	Expected profits included in future premiums (EPIFP) - Non- life business
R0790	Total Expected profits included in future premiums (EPIFP)

Total	Tier 1 unrestricted	Tier 1 restricted	Tier 2	Tier 3
C0010	C0020	C0030	C0040	C0050
50,000	50,000		0	
0	0		0	
57,500	57,500		0	
0		0	0	0
0	0			
0		0	0	0
0		0	0	0
-15,571	-15,571			
15,500		0	15,500	0
0				0
0	0	0	0	0
0				
0	0	0	0	
107,429	91,929	0	15,500	0

0				
0				
0				
0				
0				
0				
0				
0				
0				
0				
0			0	0

107,429	91,929	0	15,500	0
107,429	91,929	0	15,500	
107,429	91,929	0	15,500	0
94,127	91,929	0	2,199	

38,353
10,993
280.10%
856.22%

C0060
91,929
0
107,500
0
-15,571

13,588
13,588

## S.25.01.21

### Solvency Capital Requirement - for undertakings on Standard Formula

R0010 Market risk  
R0020 Counterparty default risk  
R0030 Life underwriting risk  
R0040 Health underwriting risk  
R0050 Non-life underwriting risk  
R0060 Diversification

R0070 Intangible asset risk

R0100 **Basic Solvency Capital Requirement**

#### Calculation of Solvency Capital Requirement

R0130 Operational risk  
R0140 Loss-absorbing capacity of technical provisions  
R0150 Loss-absorbing capacity of deferred taxes  
R0160 Capital requirement for business operated in accordance with Art. 4 of Directive 2003/41/EC  
R0200 **Solvency Capital Requirement excluding capital add-on**  
R0210 Capital add-ons already set  
R0220 **Solvency capital requirement**

#### Other information on SCR

R0400 Capital requirement for duration-based equity risk sub-module  
R0410 Total amount of Notional Solvency Capital Requirements for remaining part  
R0420 Total amount of Notional Solvency Capital Requirements for ring fenced funds  
R0430 Total amount of Notional Solvency Capital Requirements for matching adjustment portfolios  
R0440 Diversification effects due to RFF nSCR aggregation for article 304

#### Approach to tax rate

R0590 Approach based on average tax rate

#### Calculation of loss absorbing capacity of deferred taxes

R0640 LAC DT  
R0650 LAC DT justified by reversion of deferred tax liabilities  
R0660 LAC DT justified by reference to probable future taxable economic profit  
R0670 LAC DT justified by carry back, current year  
R0680 LAC DT justified by carry back, future years  
R0690 Maximum LAC DT

Gross solvency capital requirement	USP	Simplifications
C0110	C0090	C0120
9,262		
5,296		
0		
495		
22,474		
-8,025		

#### USP Key

**For life underwriting risk:**  
1 - Increase in the amount of annuity benefits  
9 - None

**For health underwriting risk:**  
1 - Increase in the amount of annuity benefits  
2 - Standard deviation for NSLT health premium risk  
3 - Standard deviation for NSLT health gross premium risk  
4 - Adjustment factor for non-proportional reinsurance  
5 - Standard deviation for NSLT health reserve risk  
9 - None

**For non-life underwriting risk:**  
4 - Adjustment factor for non-proportional reinsurance  
6 - Standard deviation for non-life premium risk  
7 - Standard deviation for non-life gross premium risk  
8 - Standard deviation for non-life reserve risk  
9 - None

C0100
8,851
0
0
38,353
0
38,353

0
0
0
0
0

C0109
0

LAC DT
--------

C0130
0
0
0
0
0

## S.28.01.01

## Minimum Capital Requirement - Only life or only non-life insurance or reinsurance activity

## Linear formula component for non-life insurance and reinsurance obligations

R0010 MCR<sub>NL</sub> Result

C0010

10,993

R0020 Medical expense insurance and proportional reinsurance  
R0030 Income protection insurance and proportional reinsurance  
R0040 Workers' compensation insurance and proportional reinsurance  
R0050 Motor vehicle liability insurance and proportional reinsurance  
R0060 Other motor insurance and proportional reinsurance  
R0070 Marine, aviation and transport insurance and proportional reinsurance  
R0080 Fire and other damage to property insurance and proportional reinsurance  
R0090 General liability insurance and proportional reinsurance  
R0100 Credit and suretyship insurance and proportional reinsurance  
R0110 Legal expenses insurance and proportional reinsurance  
R0120 Assistance and proportional reinsurance  
R0130 Miscellaneous financial loss insurance and proportional reinsurance  
R0140 Non-proportional health reinsurance  
R0150 Non-proportional casualty reinsurance  
R0160 Non-proportional marine, aviation and transport reinsurance  
R0170 Non-proportional property reinsurance

Net (of reinsurance/SPV) best estimate and TP calculated as a whole	Net (of reinsurance) written premiums in the last 12 months
C0020	C0030
0	447
0	1,251
0	
0	1,852
0	255
5,389	6,088
22,181	20,612
34,352	15,077
353	265
0	
0	
0	
0	
147	10
0	
0	

## Linear formula component for life insurance and reinsurance obligations

R0200 MCR<sub>L</sub> Result

C0040

0

R0210 Obligations with profit participation - guaranteed benefits  
R0220 Obligations with profit participation - future discretionary benefits  
R0230 Index-linked and unit-linked insurance obligations  
R0240 Other life (re)insurance and health (re)insurance obligations  
R0250 Total capital at risk for all life (re)insurance obligations

Net (of reinsurance/SPV) best estimate and TP calculated as a whole	Net (of reinsurance/SPV) total capital at risk
C0050	C0060
0	
0	
0	
0	
	0

## Overall MCR calculation

R0300 Linear MCR  
R0310 SCR  
R0320 MCR cap  
R0330 MCR floor  
R0340 Combined MCR  
R0350 Absolute floor of the MCR  
R0400 Minimum Capital Requirement

C0070

10,993  
38,353  
17,259  
9,588  
10,993  
3,338  
10,993



**Report of the external independent auditors to the Directors of Arch Insurance (UK) Limited ('the Company') pursuant to Rule 4.1 (2) of the External Audit Part of the PRA Rulebook applicable to Solvency II firms**

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

**Opinion**

We have audited the following documents prepared by the Company as at 31 December 2020:

- The 'Valuation for solvency purposes' and 'Capital Management' sections of the Solvency and Financial Condition Report of the Company as at 31 December 2020, (**the Narrative Disclosures subject to audit**); and
- Company templates S.02.01.02, S.17.01.02, S.23.01.01, S.25.01.21 and S.28.01.01 (**the Templates subject to audit**).

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

The '**relevant elements of the Solvency and Financial Condition Report**' include information contained within the 'Capital Management' section of the Solvency and Financial Condition Report which has not been audited - this information is clearly marked as 'unaudited' and relates to the 'adjusted net asset basis' used by the company as part of its internal capital governance.

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

- The 'Summary', 'Business and performance', 'System of governance' and 'Risk profile' elements of the Solvency and Financial Condition Report;
- Company templates S.05.01.02, S.05.02.01 and S.19.01.21;
- The written acknowledgement by management of their responsibilities, including for the preparation of the Solvency and Financial Condition Report (**the Responsibility Statement**).

In our opinion, the information subject to audit in the relevant elements of the Solvency and Financial Condition Report of the Company as at 31 December 2020 is prepared, in all material respects, in accordance with the financial reporting provisions of the PRA Rules and Solvency II regulations on which they are based.

**Basis for opinion**

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

## **Conclusions relating to going concern**

Our evaluation of the Directors' assessment of the Company's ability to continue to adopt the going concern basis of accounting included:

- reviewing the assessment of principal risks and uncertainties facing the Company and comparing it with our understanding of the risks and resources of the Company; and
- reviewing the Board approved business forecasts, as well as the current and forecast Solvency II ratio (including the impact of COVID-19) and the own risk and solvency assessment (ORSA), which include a number of severe but plausible scenarios.

Based on the work we have performed, we have not identified any material uncertainties relating to events or conditions that, individually or collectively, may cast significant doubt on the Company's ability to continue as a going concern for a period of at least twelve months from the date on which the Solvency and Financial Condition Report is authorised for issue.

In auditing the Solvency and Financial Condition Report, we have concluded that the directors' use of the going concern basis of accounting in the preparation of the Solvency and Financial Condition Report is appropriate.

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

Our responsibilities and the responsibilities of the Directors with respect to going concern are described in the relevant sections of this report.

## **Emphasis of Matter - Basis of Accounting**

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

## **Other Information**

The Directors are responsible for the Other Information.

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

In connection with our audit of the Solvency and Financial Condition Report, our responsibility is to read the Other Information and, in doing so, consider whether the Other Information is materially inconsistent with the relevant elements of the Solvency and Financial Condition Report, or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the relevant elements of the Solvency and Financial Condition Report or a material misstatement of the Other Information. If, based on the work we have performed, we conclude that there is a material misstatement of this Other Information, we are required to report that fact. We have nothing to report in this regard.

## **Responsibilities of Directors for the Solvency and Financial Condition Report**

The Directors are responsible for the preparation of the Solvency and Financial Condition Report in accordance with the financial reporting provisions of the PRA rules and Solvency II regulations.

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

## **Auditors' Responsibilities for the Audit of the relevant elements of the Solvency and Financial Condition Report**

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

Our objectives are to obtain reasonable assurance about whether the relevant elements of the Solvency and Financial Condition Report 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 it is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the decision making or the judgement of the users taken on the basis of the Solvency and Financial Condition Report.

Irregularities, including fraud, are instances of non-compliance with laws and regulations. We design procedures in line with our responsibilities, outlined above, to detect material misstatements in respect of irregularities, including fraud. The extent to which our procedures are capable of detecting irregularities, including fraud, is detailed below.

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 Solvency and Financial Condition Report. We also considered those laws and regulations that have a direct impact on the Solvency and Financial Condition Report such as Solvency II Regulations and the Solvency II Directive. We evaluated management's incentives and opportunities for fraudulent manipulation of the Solvency and Financial Condition Report (including the risk of override of controls), and determined that the principal risks were related to management's judgements employed in the estimation of technical provisions, with a predominant focus on the provision for IBNR, the estimation of gross premiums written in relation to future premium cash flows, and posting of inappropriate journals or adjustments. Audit procedures performed included:

- discussions with the Audit Committee, management and Internal Audit, including consideration of known or suspected instances of non-compliance with laws and regulations 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 technical provisions, with a predominant focus on the provision for IBNR, and the estimation of gross premiums written in relation to future premium cash flows;

- testing material Solvency II adjustments applied to the Templates subject to audit;
- identifying and testing journal entries based on selected fraud risk criteria, in particular journal entries with unusual account combinations or posted by unexpected users;
- evaluating the business rationale for any significant transactions identified outside the normal course of business; 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. We are less likely to become aware of instances of non-compliance with laws and regulations that are not closely related to events and transactions reflected in the Solvency and Financial Condition Report. 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.

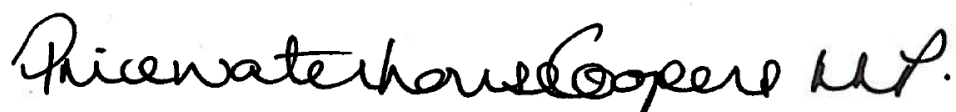
A further description of our responsibilities for the audit is located on the Financial Reporting Council's website at: [www.frc.org.uk/auditorsresponsibilities](http://www.frc.org.uk/auditorsresponsibilities). This description forms part of our auditors' report.

### **Use of this report**

This report, including the opinion, has been prepared for the Board of Directors of the Company in accordance with External Audit rule 2.1 of the Solvency II firms Sector of the PRA Rulebook and for no other purpose. We do not, in providing this report, accept or assume responsibility for any other purpose or to any other party save where expressly agreed by our prior consent in writing.

### **Report on Other Legal and Regulatory Requirements**

In accordance with Rule 4.1 (3) of the External Audit Part of the PRA Rulebook for Solvency II firms we are also required to consider whether the Other Information is materially inconsistent with our knowledge obtained in the audit of the Company's statutory financial statements. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.



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*8 April 2021*