

Registered in Switzerland No. CHE-270.372.844

# **CANOPIUS AG**

## **ANNUAL REPORT AND FINANCIAL STATEMENTS**

**FOR THE YEAR ENDED  
31 DECEMBER 2018**

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Key Statistics <sup>1</sup>	2018 \$m	2017 \$m
Total shareholders' interests	681.8	570.9
Financial resources <sup>2</sup>	919.3	1274.0
Gross premiums written	1,367.8	1,271.2
Net premiums earned	1,211.5	1,184.0
Total loss after taxation	(63.6)	(244.5)
Net loss ratio	67%	83%
Combined ratio	104%	122%

Net premiums earned represent 'net premiums written' (being premiums written gross of acquisition costs and exclusive of premium taxes; less reinsurance premiums payable) and the change in gross and reinsurers' share of unearned premium.

The net loss ratio is calculated by dividing 'net claims incurred' (being net claims paid and the movement in net claims reserves) by 'net premiums earned'.

The combined ratio is calculated by dividing 'net claims incurred' and underwriting expenses by 'net premiums earned'.

<sup>1</sup> Amounts presented are determined from the financial statements except as noted below.

<sup>2</sup> Financial resources represent total shareholders' interests plus drawn unsecured letter of credit facilities.

## Chairman's Statement

2018 was a landmark year for Canopus with the completion of its acquisition by a private equity consortium led by Centerbridge Partners LP ("Centerbridge") and including Gallatin Point Capital LLC. The acquisition was awarded 'Transaction of the Year' at the Insurance Insider London Markets awards ceremony and brought an end to four years of ownership by Sompo Holdings Inc. Canopus is once again a standalone business with entrepreneurial shareholders, including management, and is beginning an exciting new chapter in its fifteen year history.

Whilst our ownership has changed, our ambition has not. We are seeking to build a world class, independent global specialty insurance and reinsurance business, primarily centred on the Lloyd's platform and with our principal base of operations in London, with additional hubs in key locations around the world including Singapore, Bermuda and the United States. Canopus will continue to be distinguished by its obsessive focus on underwriting excellence, its global reach, its operational excellence and winning culture and will demonstrate strong customer satisfaction and high employee engagement.

During 2018 Canopus continued on a journey which began three years ago to improve the profitability of its underwriting portfolio. This necessitated some painful adjustments which included reducing volumes in a number of lines of business and exiting others completely. The extent of these changes is highlighted by the following statistics: in the three years ended 31 December 2018, Canopus has reduced its managed premiums by 5% from \$1,584m to \$1,501m. Within this overall reduction, over the last four years and for 2019, we have and continue to lower the volume in our 10% worst performing classes by 84% and by 59% in what we refer to as our 'extended action' classes. At the same time, we have grown our core portfolio by more than \$300m or 33% from \$932m to \$1,241m. We are confident that these changes will lead to increased profitability in future periods, as we concentrate our underwriting focus on fewer classes but where we have a sustainable market proposition and provide expertise and relevance to our clients and brokers. Our results should also prove less volatile in future as, following our change in ownership, we have reduced our catastrophe risk exposures as at 1 January 2019 by 55% from their peak at 1 January 2017.

Away from London, the Group had considerable success in hiring top-class talent in Singapore and New York which will give significant impetus to our growth ambitions in those regions. We also launched our ILS capability in Bermuda and have developed digital distribution capabilities for a variety of natural catastrophe perils including inland flood and California wildfire.

Although underwriting conditions generally remain challenging in most classes, there are signs of modest improvement in the rating environment. Despite this improvement, we do not have significant ambition for growth through organic means at present; we need to see further positive rate movement before doing so. Whilst this is true at an aggregate portfolio level, there are numerous areas where we are seeking meaningful growth in 2019. This includes Accident & Health and Political Risk & Trade Credit in London, all classes of insurance and reinsurance in Asia Pacific, and Management & Professional Lines and Marine out of New York.

In the absence of conditions that are conducive to meaningful organic growth we are actively pursuing growth through Merger and Acquisition activity. The recently announced merger between Canopus and AmTrust at Lloyd's is an extremely exciting development and will elevate our Lloyd's business into the top five syndicates in terms of gross premiums written. More importantly, it will broaden our product offering, further enhance our position as a market leader in our chosen classes, and reduce volatility in our results.

Against this positive outlook, it must be recognised that 2018's results were disappointing with a loss after tax of \$64m. After the historic natural catastrophe losses of 2017, our results for 2018 were once again impacted by such events, including Hurricanes Florence and Michael and the California Wildfires, which generated aggregate net losses of \$103m and a significant man-made disaster – the Lurssen shipyard fire which cost \$19m (net).

On the back of the unprecedented losses in 2017, the improvement in the rating environment in 2018 fell short of our expectation and benchmarks. Nevertheless we were able to identify various profitable growth opportunities notably across our Specialist Consumer Product, North American Facilities and Global Specialty classes of business which led to an increase of 8% in gross premiums written to \$1,368m.

## Chairman's Statement (continued)

Administrative expenses<sup>1</sup> remained well-controlled, reducing by \$17m or 11%. At a time of compressed underwriting margins, continued vigilance on expenses is vital. Investment income was impacted by both difficult equity markets and rising US interest rates, which generated significant mark to market losses (\$28m) at year end. Happily, substantially all of this has been recouped in the first quarter of 2019.

We enter 2019 with a strong sense of enthusiasm, confidence and momentum, buoyed by improving market conditions and the recently agreed transactions with AmTrust Financial Services Inc. ("AFSI") and Samsung Fire & Marine Insurance ("SFMI"). Together these two developments constitute a huge step change in the Canopus franchise.

Following the acquisition of AmTrust at Lloyd's, Canopus will become one of the top five insurers at Lloyd's with gross written premiums of c\$2.2bn. The combined portfolio will be more diverse and less volatile and enable us to enhance our market proposition and deploy our underwriting expertise to ensure increased relevance to our brokers and clients. As part of the transaction AFSI will become a significant minority shareholder in Canopus.

As part of its plan to become a leading global insurer, SFMI will also become a significant minority shareholder in Canopus. With its exceptional financial strength and world-renowned brand, SFMI will become not only an investor in Canopus but also a trusted business partner with whom we intend to collaborate actively around the world to develop our respective businesses.

In closing I would like to thank all of our colleagues at Canopus for their unwavering support in 2018 and look forward to welcoming our new colleagues from AmTrust at Lloyd's, and our new strategic partner SFMI, to Canopus in the near future.



Michael Watson  
Chairman and CEO

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<sup>1</sup> Administrative expenses reflect other operating and administrative expenses, less foreign exchange and direct commissions.

## **Management Report**

The directors of Canopus AG present their Management Report for the Group for the year ended 31 December 2018.

### **Review of the business**

The principal activity of the Group is the underwriting of insurance and reinsurance business transacted both through direct channels and via delegated underwriting.

With effect from 4 January 2018, the Company changed its name from Sompo Canopus AG to Canopus AG ("CAG").

The result for the year ending 31 December 2018 was a loss after tax to shareholders of \$63.6m (2017: Loss of \$244.5m). The key performance indicators are shown in the table on page 3.

The main drivers of the Group's performance were:

- Catastrophe event net losses of \$103m as a result of hurricane Florence and Michael and the California Wildfires;
- A significant shipyard fire (Sassi yacht loss) of \$19m;
- Strengthening of prior period reserves;
- A continued focus on strict control of operating expenses;
- Mark to market losses on the investment portfolio;
- Adverse foreign exchange movements due to strengthening of the US Dollar against Sterling;
- Partially offset by a reduction in expenses (that exclude currency movements).

These results represent a significant improvement versus 2017 but do reflect another challenging year for the Group and the market generally. Underwriting discipline continues to be exercised and business has been declined where rate or profitability expectations have not been met.

Gross written premiums increased by 8% to \$1,368m (2017: \$1,271m) primarily driven by targeted growth in Specialist Consumer Products, North American Facilities and Credit and Political Crisis.

Across the market, 2018 has once again seen material losses from natural catastrophes including Hurricanes Florence and Michael and the wildfires in California. The Group experienced significant losses on these events as reflected in the loss generated in the year as stated above.

The Group's investment portfolio achieved a return of \$8.4m in 2018 (2017: \$30.8m), the 2018 performance being heavily impacted by mark to market losses. This reflects the impact of a rising interest rate environment in the US and some uncertainty in the equity markets which had a broader effect on the valuation of risk assets.

### **Economic and Operating Outlook**

Following a protracted period of soft market conditions, the early part of 2019, including the January renewal season, has seen some limited positive rate momentum in selected classes but trading conditions will continue to be highly competitive and challenging in the near future.

Investment markets have been volatile through 2018 and this is expected to continue for some time with continuing uncertainty around interest rates, equity markets and the major economies.

Risks to UK economic growth remain especially given the absence of a direction on Brexit. EU membership and access to the single market has enabled underwriters at Lloyd's to underwrite insurance and reinsurance from all of the other member states on a cross-border basis.

Underwriters operate under a "passport" system, which allows them to conduct business throughout the EU while being regulated and supervised by the Prudential Regulation Authority ("PRA"). To mitigate this risk, Lloyds has established a subsidiary in Brussels and Canopus' Syndicate 4444 is already using this arrangement in continuing to provide services to our European partners.

## Management Report (continued)

### Risk assessment and management

In the normal course of business, the Group is exposed to many risks. Risk policies are in place for the major risk categories. Please refer to notes 31 and 32 of these consolidated financial statements for more details.

### Strategy

Our goal is to establish Canopus as a world class global specialty (re)insurer characterised by strong customer satisfaction, high employee engagement, operating performance in excess of peers, and a high return on equity with low volatility.

Our strategy to achieve this goal comprises:

- **Underwriting focus**  
Through investing in the best people, and keeping an obsessive focus on performance. The pursuit of high margin non-correlating classes to balance catastrophe exposure, utilising proprietary pricing and portfolio optimisation tools, and seeking diversification with profit focus.
- **Global reach**  
While London remains our core physical centre of operations, we will seek to develop an on the ground presence in key markets, especially the US and Asia-Pacific. At the same time, we can leverage our technology capabilities to revolutionise our distribution in a manner which is increasingly location agnostic.
- **Operational excellence**  
Promoting efficient capital management to optimise return on equity, and by building a scalable, streamlined business model with outsourced support functions.
- **Winning culture**  
Our people are the key to our success. We are results focused; team oriented; honest and open.
- **Inorganic growth**  
Complementing organic growth, Canopus seeks to identify strategic M&A opportunities to develop the business

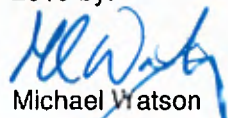
### Future developments

On the 18th April 2019, Fortuna Holdings Limited ("FHL"), the immediate parent company of CAG, agreed a definitive sale and purchase agreement that will see the merger of its Lloyd's business with that of AmTrust at Lloyd's, a division of AmTrust Financial Services Inc ("AFSI"). Following completion, the Group will assume the management of AmTrust Syndicate 1861. As part of the transaction AFSI will become a significant minority shareholder in the Group.

On 2nd May 2019 FHL entered into a strategic partnership with Samsung Fire & Marine Insurance ("SFMI"). Under the terms of the transaction, SFMI will become a significant minority shareholder in the Group.

The above transactions are both subject to necessary regulatory approval and are expected to close in the third quarter of 2019.

The management report was approved by the Board on 23 April 2019 and signed on its behalf on 23 May 2019 by:

  
Michael Watson

Director

Ian Owen

Director



**Directors and Professional Advisers**

**Directors**

Michael Watson  
Paul Ceurvorst (appointed 25 May 2018)  
Michael Duffy (appointed 25 May 2018)  
Peter Hazell (appointed 25 May 2018)  
Shigeru Ehara (resigned 9 March 2018)  
Nigel Frudd (resigned 9 March 2018)  
Hans Künzle  
Paul Meader  
Ian Owen  
Atsushi Mizuguchi (resigned 9 March 2018)

**Registered Office**

4<sup>th</sup> Floor, Freigustrasse 16  
CH-8002, Zurich  
Switzerland

**Company Number**

CHE-270.372.844

**Independent Auditors**

Ernst & Young AG  
Maagplatz 1  
8005, Zurich  
Switzerland



To the General Meeting of  
**Canopus AG, Zürich**

Zürich, 23 May 2019

## Statutory auditor's report on the audit of the consolidated financial statements



### Opinion

We have audited the consolidated financial statements of Canopus AG and its subsidiaries (the Group), which comprise the consolidated statement of financial position as at 31 December 2018 and the consolidated statement of income, consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, the consolidated financial statements (pages 11 to 61) give a true and fair view of the consolidated financial position of the Group as at 31 December 2018, and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRS) and comply with Swiss law.



### Basis for opinion

We conducted our audit in accordance with Swiss law, International Standards on Auditing (ISAs) and Swiss Auditing Standards. Our responsibilities under those provisions and standards are further described in the Auditor's responsibilities for the audit of the consolidated financial statements section of our report.

We are independent of the Group in accordance with the provisions of Swiss law and the requirements of the Swiss audit profession, as well as the IESBA Code of Ethics for Professional Accountants, 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.



### Other information in the annual report

The Board of Directors is responsible for the other information in the annual report. The other information comprises all information included in the annual report, but does not include the consolidated financial statements, the stand-alone financial statements and our auditor's reports thereon.

Our opinion on the consolidated financial statements does not cover the other information in the annual report and we do not express any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information in the annual report and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. 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.



### **Responsibility of the Board of Directors for the consolidated financial statements**

The Board of Directors is responsible for the preparation of the consolidated financial statements that give a true and fair view in accordance with IFRS and the provisions of Swiss law, and for such internal control as the Board of Directors determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, the Board of Directors is responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the Board of Directors either intends to liquidate the Group or to cease operations, or has no realistic alternative but to do so.



### **Auditor's responsibilities for the audit of the consolidated financial statements**

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

A further description of our responsibilities for the audit of the consolidated financial statements is located at the website of EXPERTsuisse: <http://www.expertsuisse.ch/en/audit-report-for-public-companies>. This description forms part of our auditor's report.

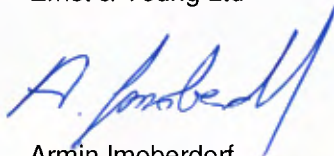


### **Report on other legal and regulatory requirements**

In accordance with article 728a para. 1 item 3 CO and the Swiss Auditing Standard 890, we confirm that an internal control system exists, which has been designed for the preparation of consolidated financial statements according to the instructions of the Board of Directors.

We recommend that the consolidated financial statements submitted to you be approved.

Ernst & Young Ltd



Armin Imoberdorf  
Licensed audit expert  
(Auditor in charge)



Sergio Sardo  
U.S. Certified Public Accountants (CPA)

**Consolidated statement of profit or loss**

for the year ended 31 December 2018

\$'000	Notes	2018	2017
Gross premiums	4a	1,312,435	1,329,385
Premiums ceded to reinsurers	4b	(177,748)	(211,262)
Reinsurance to close	4c	76,836	65,883
<b>Net premiums</b>		<b>1,211,523</b>	<b>1,184,006</b>
Fees and commission income	5	9,191	7,535
Investment income	6	35,971	26,355
Net realised losses	7	(9,759)	(602)
Fair value (losses)/gains	8	(17,830)	5,056
Other operating income		4,490	6,267
<b>Other revenue</b>		<b>22,063</b>	<b>44,611</b>
<b>Total revenue</b>		<b>1,233,586</b>	<b>1,228,617</b>
Gross benefits and claims paid	9a	(916,770)	(805,771)
Claims ceded to reinsurers	9b	170,755	99,701
Gross change in insurance contract liabilities	9a	14,069	(372,438)
Change in insurance contract liabilities ceded to reinsurers	9b	1,224	167,581
Reinsurance to close	9c	(76,836)	(65,883)
<b>Net benefits and claims</b>		<b>(807,558)</b>	<b>(976,810)</b>
Finance costs	10	(3,807)	(1,997)
Other operating and administrative expenses	11	(497,486)	(488,536)
<b>Other expenses</b>		<b>(501,293)</b>	<b>(490,533)</b>
<b>Total benefits, claims and other expenses</b>		<b>(1,308,851)</b>	<b>(1,467,343)</b>
<b>Loss before tax</b>		<b>(75,265)</b>	<b>(238,726)</b>
Income tax credit/(expense)	13(a)	11,629	(5,804)
<b>Loss for the year</b>		<b>(63,636)</b>	<b>(244,530)</b>

The notes on pages 16 to 61 form part of these consolidated financial statements.

**Consolidated statement of comprehensive income**

for the year ended 31 December 2018

\$'000	2018	2017
<b>Loss for the year</b>	(63,636)	(244,530)
<b>Other comprehensive income (OCI):</b>		
OCI that may be reclassified to profit or loss in subsequent period:		
Currency translation differences	(2,465)	2,653
<b>Total comprehensive loss recognised for the year</b>	(66,101)	(241,877)

All the above amounts are derived from continuing operations and attributable to equity holders of the parent company.

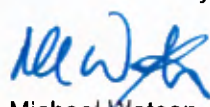
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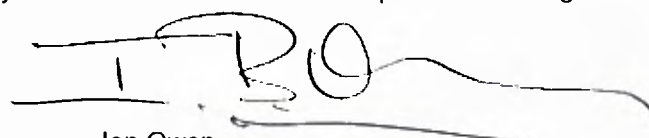
**Consolidated statement of financial position**

as at 31 December 2018

\$'000	Notes	2018	2017
<b>Assets</b>			
Intangible assets	14	31,698	30,560
Property and equipment	15	736	1,782
Deferred acquisition costs	16	184,962	158,951
Reinsurance assets	17	611,633	610,984
Financial assets			
Financial assets at fair value through profit or loss	18	1,989,790	1,889,310
Derivative financial instruments	19	1,484	3,520
Deferred tax asset	13(d)	3,516	3,536
Income tax receivable	13(c)	12,850	-
Insurance receivables	21	618,512	636,684
Trade and other receivables	22	42,642	43,950
Other assets		50,801	67,040
Cash and cash equivalents	23	165,563	245,384
<b>Total assets</b>		<b>3,714,187</b>	<b>3,691,701</b>
<b>Equity and liabilities</b>			
<b>Equity attributable to equity holders of parent</b>			
Issued share capital	24	106	106
Capital reserves		759,956	582,956
Foreign currency translation reserve		(53,130)	(50,665)
Retained earnings		(25,135)	38,501
<b>Total equity</b>		<b>681,797</b>	<b>570,898</b>
<b>Liabilities</b>			
Insurance contract liabilities	25	2,710,302	2,689,174
Derivative financial instruments	19	989	4,576
Income tax payable	13(c)	-	11,730
Insurance payables	27	264,768	330,467
Trade and other payables	28	56,331	84,856
<b>Total liabilities</b>		<b>3,032,390</b>	<b>3,120,803</b>
<b>Total equity and liabilities</b>		<b>3,714,187</b>	<b>3,691,701</b>

These financial statements were approved by the Board of Directors on 23 April 2019 and signed on its behalf on 23 May 2019 by:

  
Michael Watson  
Director

  
Ian Owen  
Director

The notes on pages 16 to 61 form part of these consolidated financial statements.

**Consolidated statement of changes in equity**

for the year ended 31 December 2018

## Attributable to equity holders of the parent

\$'000	Notes	Issued share capital	Contributed capital	Foreign currency translation reserve	Retained earnings	Total equity
<b>At 01 January 2017</b>		106	582,956	(53,318)	283,031	812,775
Loss for period		-	-	-	(244,530)	(244,530)
Other comprehensive income		-	-	2,653	-	2,653
Total comprehensive income		-	-	2,653	(244,530)	(241,877)
<b>At 31 December 2017</b>		106	582,956	(50,665)	38,501	570,898
Loss for period		-	-	-	(63,636)	(63,636)
Other comprehensive income		-	-	(2,465)	-	(2,465)
Total comprehensive income		-	-	(2,465)	(63,636)	(66,101)
Capital Contribution		-	177,000	-	-	177,000
<b>At 31 December 2018</b>		106	759,956	(53,130)	(25,135)	681,797

The notes on pages 16 to 61 form part of these consolidated financial statements.

**Consolidated statement of cash flows**

for the year ended 31 December 2018

\$'000	Notes	2018	2017
<b>Operating activities</b>			
Loss before tax		(75,265)	(238,726)
Adjustment for:			
Change in operating assets	30	32,531	(111,367)
Change in operating liabilities	30	(72,107)	313,270
Financial income and expense		(22,392)	(23,756)
Non-cash items included in profit before tax:			
Fair value losses/(gains)	8	17,830	(5,056)
Movement in deferred acquisition costs		(26,011)	18,033
Amortisation of intangibles	11	7,088	5,463
Impairment of intangibles	14	-	6,000
Depreciation of property and equipment	11	961	1,269
Loss on disposal of property and equipment		-	811
Loss on disposal of intangible assets		-	866
Profit on disposal of a business		-	(362)
Income tax paid	13(c)	(13,642)	(10,387)
<b>Net cash flows from operating activities</b>		<b>(151,007)</b>	<b>(43,942)</b>
<b>Investing activities</b>			
Purchases of financial assets		(1,367,177)	(1,068,190)
Sales of financial assets		1,243,983	1,097,797
Investment income		34,725	26,355
Proceeds from disposal of a business		-	4,869
Purchases of intangible assets	14	(8,338)	(2,063)
Purchases of property and equipment	15	(115)	(719)
<b>Net cash flows generated from investing activities</b>		<b>(96,922)</b>	<b>58,049</b>
<b>Financing activities</b>			
Capital contribution		177,000	-
Finance costs	10	(3,807)	(1,997)
<b>Net cash flows from/(used in) financing activities</b>		<b>173,193</b>	<b>(1,997)</b>
Net (decrease)/increase in cash and cash equivalents		(74,736)	12,110
Cash and cash equivalents at beginning of year		245,384	233,018
Effect of exchange rate changes on cash and cash equivalents		(5,085)	256
<b>Cash and cash equivalents at end of year</b>	<b>23</b>	<b>165,563</b>	<b>245,384</b>

Overseas deposits in 2018 of \$50.8m and 2017 of \$67m have been reclassified from cash and cash equivalents to other assets.

The notes on pages 16 to 61 form part of these consolidated financial statements.

## Notes to the consolidated financial statements

Year ended 31 December 2018

### 1. Corporate information

CAG, incorporated in Switzerland, is the parent undertaking and controlling party of the Canopus group of companies (the "Group"). A summary of the principal accounting policies applied in the preparation of these consolidated financial statements is set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

### 2. Significant accounting policies, judgements and estimates

#### 2.1 Basis of preparation and presentation

CAG has elected to prepare its consolidated financial statements in accordance with International Financial Reporting Standards ("IFRS") and with the provisions of Swiss law. Since 2002, the standards adopted by the International Accounting Standards Board ("IASB") have been referred to as IFRS. The standards from prior years continue to bear the title 'International Accounting Standards' ("IAS"). Insofar as a particular standard is not explicitly referred to, the two terms are used in these financial statements synonymously. Compliance with IFRS also includes the adoption of interpretations issued by the IFRS Interpretations Committee ("IFRS IC").

These financial statements are prepared in accordance with full IFRS and presented in US dollars.

The financial statements have been prepared under the historical cost convention as modified by the revaluation of financial assets and liabilities which are valued at fair values.

The preparation of financial statements in conformity with IFRS requires the Group's Board to exercise its judgement in applying the Group's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions or estimates are significant to the consolidated financial statements are explained in Note 2.5 below.

#### 2.2 Basis of consolidation

The consolidated financial statements incorporate the assets, liabilities and results, on an annual accounting basis, of the Group and its subsidiaries including the Group's underwriting activities through its participation on Lloyd's syndicates. Subsidiaries are all entities over which the Group has control. The Group controls an entity when the Group is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are deconsolidated from the date that control ceases. The financial statements of subsidiaries are prepared for the same reporting year-end as the Group. Consolidation adjustments are made to convert subsidiary financial statements prepared under UK or other local GAAP into IFRS to remove the effect of any different accounting policies. All inter-company balances, profits and transactions are eliminated on consolidation.

A list of the principal subsidiaries included in these financial statements is contained in Note 3.2.

#### ***Business combinations and goodwill***

The Group uses the 'acquisition method of accounting' under IFRS 3 – 'Business Combinations', to account for the acquisition of companies. Under IFRS 3, the consideration to purchase a business is recorded at fair value at the acquisition date. These are re-estimated in subsequent financial statements (after the expiry of the measurement period for adjustment to the initial provisional fair value, which should not exceed one year from the date of acquisition) and any changes in estimates are taken to the Statement of Comprehensive Income. Adjustments to fair value can only be made during the measurement period if they relate to conditions that existed before acquisition and any changes due to events after the acquisition will go to the statement of profit or loss.



## Notes to the consolidated financial statements

Year ended 31 December 2018

### 2.2 Basis of consolidation (continued)

All acquisition-related expenses are charged to the statement of profit or loss when incurred, within other operating and administrative expenses. The excess of the cost of acquisition over the fair value of the Group's share of the identifiable assets acquired net of liabilities and contingent liabilities is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognised directly in the statement of profit or loss for the period.

After initial recognition, goodwill is measured at cost less any accumulated impairment losses. For the purposes of impairment testing, goodwill acquired in a business combination is allocated to an appropriate cash generating unit (CGU) that is expected to benefit from the combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units.

Where goodwill has been allocated to a CGU and part of the operation within that unit is disposed of, the goodwill associated with the disposed operation is included in the carrying amount of the operation when determining the gain or loss on disposal of the operation. Goodwill disposed of in this circumstance is measured based on the relative values of the operation disposed of and the portion of the cash-generating unit retained.

### 2.3 Summary of significant accounting policies

#### (a) Classification and accounting for insurance contracts

Insurance contracts (including inwards reinsurance contracts) are defined as those that transfer significant insurance risk. Insurance risk is considered significant if, and only if, an insured event could cause an insurer to pay significant additional benefits above the premiums received and interest earned thereon, excluding scenarios that lack commercial substance. Such contracts remain insurance contracts until all rights and obligations are extinguished or expire. Contracts that do not transfer significant insurance risk are accounted for as financial transactions.

The Group adopts an annual basis of accounting for insurance contracts whereby the incurred cost of claims, commission and related expenses are charged against the earned proportion of premiums, net of reinsurance as follows:

#### (i) Premiums

Gross premiums written, stated gross of acquisition costs and exclusive of premium taxes, relates to business incepted during the year and adjustments to premiums booked in prior years; and includes estimates, based on underwriters' estimates or past experience, of premiums due but not yet processed.

Unearned premiums represent the proportion of premiums written in the year that relate to unexpired terms of policies in force at the balance sheet date, calculated by reference to the expected incidence of insurance risk over the period of cover.

Reinsurance premiums payable are accounted for with regard to the incidence of insurance risk of the direct or inwards reinsurance business to which they relate. The provision for reinsurers' share of unearned premiums represents that part of reinsurance premiums written which is estimated to be earned in the following financial years.

#### (ii) Insurance claims and claims settlement expenses

Insurance claims and claims settlement expenses comprise claims and related expenses paid in the year and changes in the provisions for outstanding claims, including provisions for claims incurred but not reported ("IBNR") and related expenses, together with any other adjustments to claims from prior years.

## Notes to the consolidated financial statements

Year ended 31 December 2018

### 2.3 Summary of significant accounting policies (continued)

#### (a) Classification and accounting for insurance contracts (continued)

##### (ii) Insurance claims and claims settlement expenses (continued)

Provision is made at the period-end for the estimated cost of IBNR claims to the Group. The estimated cost of claims includes expenses to be incurred in settling claims less the expected value of salvage and other recoveries. There is inherent uncertainty in establishing claims provisions and it is likely that the final outcome will prove to be different from the original estimate of the liability. Adjustments to the amounts of claims provisions established in prior years are included in the financial statements in the period in which the adjustments are made. The claims provisions are reviewed regularly.

Estimating IBNR claims is inherently more uncertain than estimating the cost of claims notified, for which more information about the claim event is generally available.

Classes of business where the IBNR proportion of the total claims provisions is high will typically display greater variations between initial estimates and final outcomes because of the greater degree of difficulty of estimating these reserves. Classes of business where claims are typically reported relatively quickly after the claim event tend to display lower levels of volatility in the claims provisions.

Where possible the Group adopts multiple techniques, often based on historical claims data, to estimate the required level of claims provisions. The estimates given by the various methodologies assist in setting the range of possible outcomes and the most appropriate estimation technique is selected taking into account the characteristics of the business class and the extent of the development of each underwriting year of account.

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

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

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

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

Claims provisions are calculated gross of any reinsurance recoveries. Separate estimates are made of the amounts that will be recoverable from reinsurers and the potential cost of default, having regard to available data on the financial strength of each of the reinsurance companies.

Claims reserved as non-life annuities are discounted for investment earnings that may be expected to arise in the future on funds retained to meet the future liabilities. All other claims provisions are undiscounted.

There are a number of different types of business written by the Group, including property, liability and marine business, broadly categorised as either "short tail" or "long tail" business. The Group also writes reinsurance business. The characteristics of this business mirror those of the underlying business ceded to the syndicate.

## Notes to the consolidated financial statements

Year ended 31 December 2018

### 2.3 Summary of significant accounting policies (continued)

#### (a) Basis of accounting for insurance contracts (continued)

##### **Short tail business**

Property, motor and accident and health business are generally "short tail", whereby there is not normally a significant delay between the occurrence of the claim and the claim being reported. The costs of claims notified at the balance sheet date are estimated on a case-by-case basis to reflect the individual circumstances of each claim. The ultimate expected cost of claims, including IBNR claims, is projected from this data by reference to historical claims development data, which show how estimates of claims incurred in previous periods have developed over time.

##### **Longer tail business**

Casualty, liability (including motor liability) and marine claims are generally longer tail and so a larger element of the claims provision relates to IBNR claims. Claims estimates for business in this category are derived from a combination of expected loss ratios and actual claims experience, using a predetermined formula whereby increasing weight is given to actual claims experience as time passes. The initial estimates of the claims provisions are based on the experience of previous years and available market data adjusted for factors such as premium rate changes and claims inflation. For liability claims, the assessment of claims is particularly sensitive to the level of court awards and to the development of legal precedent on matters of contract and tort. The liability classes of business are also subject to the emergence of new types of latent claims.

##### **Reinsurance recoveries**

Reinsurance recoveries in respect of IBNR claims are assumed to be consistent with the historical recoveries on paid and outstanding claims, adjusted to reflect changes in the nature and extent of the Group's reinsurance programmes.

#### (iii) Deferred acquisition costs

Deferred acquisition costs, representing a proportion of commission and other acquisition costs that relate to policies in force at the period end, are amortised over the period in which the related premiums are earned. Deferred acquisition costs are reviewed at the end of each reporting period and are written off if they are no longer considered to be recoverable.

#### (iv) Unexpired risks

At each reporting date, the Group reviews its unexpired risk and a liability adequacy test is performed to determine whether there is any overall excess of expected claims and deferred acquisition costs over unearned premiums. This calculation uses current estimates of future contractual cash flows after taking account of the investment return expected to arise on assets relating to the relevant non-life insurance technical provisions. If these estimates show that the carrying amount of the unearned premiums (less related deferred acquisition costs) is inadequate, the deficiency is recognised in the statement of profit or loss by setting up a provision for premium deficiency.

At 31 December 2018 and 31 December 2017 the Group did not have an unexpired risk provision.

#### (v) Reinsurance to close ("RITC")

Each syndicate's underwriting year of account is normally closed after the end of its third year by means of reinsurance into the following underwriting year of account, which reinsures all liabilities for the closing year in return for a premium determined by the syndicate's managing agent.

To the extent that the Group changes its participation on a managed syndicate from one underwriting year of account to the next, it is a net receiver or payer of premium to reinsure the earlier year of account into the latter. This RITC premium and the related net claims provision are recognised as income and expense in the financial year in which the RITC contract is effective. It is represented in the balance sheet by the change in share of assets and liabilities transferred between the two years of account of the syndicates.

**Notes to the consolidated financial statements**

Year ended 31 December 2018

**2.3 Summary of significant accounting policies (continued)****(vi) Outwards reinsurance contracts**

Outwards reinsurance contracts are contracts entered into by the Group with reinsurers whereby the Group may recover a proportion of losses on insurance contracts written by the Group. Reinsurance contracts that do not transfer significant insurance risk are accounted for as financial transactions.

The benefits to which the Group is entitled under its outwards reinsurance contracts are recognised as reinsurance assets. These assets consist of balances due from reinsurers and future receivables estimated based on claims payable and IBNR claims for each class of business, having regard to the terms of the relevant reinsurance contracts, net of estimated irrecoverable amounts after assessing the financial strength of the reinsurers. Reinsurance liabilities are primarily premiums payable for reinsurance contracts.

The Group assesses its reinsurance assets for impairment. If there is evidence of impairment, then the carrying amount is reduced to its recoverable amount and the impairment loss is recognised in the statement of profit or loss.

**(vii) Receivables and payables related to insurance contracts**

Receivables and payables include amounts due to and from agents, brokers and insurance contract holders. If there is evidence that the insurance receivable is impaired, the Group reduces the carrying amount of the insurance receivable accordingly and recognises that impairment loss in the statement of profit or loss.

**(b) Other operating and administrative expenses**

Other operating and administrative expenses include exchange gains and losses, underwriting expenses, such as brokerage and commissions, and non-underwriting expenses of the Group after the elimination of intra-group charges.

**(c) Employee benefits**

The Group operates defined contribution pension plans and a closed defined benefit pension scheme for its employees. The defined benefit pension scheme was acquired in 2010 with the acquisition of a new business. The scheme is closed to new entrants and has ceased accruing new benefits for current members. Any liability recognised in the consolidated balance sheet in respect of the scheme ("scheme liability") is the present value of the defined benefit obligation less the fair value of the scheme's assets as at the balance sheet date. Scheme assets exclude any insurance contracts issued by the Group. The defined benefit obligation is calculated annually by independent actuaries using the projected unit-credit method. To the extent that a surplus emerges on the scheme liability, it is only recognised as an asset in the balance sheet when it is probable that future economic benefits will be recovered by the scheme sponsor in the form of refunds or reduced contributions.

The cost of providing pension contributions for all staff is charged to the statement of profit or loss in the period to which it relates.

**(d) Finance costs**

Finance costs consist of interest charges and fees accruing on the Group's borrowings, bank facilities, costs of arrangements with the parent company and third parties that secure or provide Funds at Lloyd's ("FAL") for the Group's corporate members underwriting on Lloyd's syndicates. Arrangement fees in respect of financing arrangements are charged over the life of the related facilities.

## Notes to the consolidated financial statements

Year ended 31 December 2018

### 2.3 Summary of significant accounting policies (continued)

#### (e) Revenue recognition:

##### Fee and Commission Income

Fees, including profit commissions, receivable by the Group's subsidiaries managing Lloyd's syndicates ("managing agents") are accounted for on the following bases:

- i. Managing agents' fees relate to managing and operating the Lloyd's syndicate, and are therefore provided continuously throughout the year. These services are considered a single performance obligation. The price is fixed with no variable element and is matched against the single performance obligation. The passing of time is used to measure the amount of fees to be recognised.
- ii. Profit commission becomes payable once the year of account is profitable. Profit commission is recognised to the extent that it is highly probable it will not be subject to significant reversal.
- iii. Insurance services – commission and service fees are recognised at the point in time that the performance obligations are satisfied.

##### Other operating income

Other operating income, including one off items, is recognised in the period to which it relates.

#### (f) Foreign currency translation

##### *Functional and presentation currency*

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates (the "functional currency"). The consolidated financial statements are presented in US dollars which is the Group's presentation currency.

##### *Transactions and balances*

Foreign currency transactions are translated into the functional currency using average, rather than spot, exchange rates as these rates do not fluctuate significantly. Foreign exchange gains and losses resulting from the settlement of such transactions and from the retranslation at year end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the statement of profit or loss for the period. Non-monetary assets and liabilities (principally unearned premium reserves and deferred acquisition costs) carried at historical cost are translated in the balance sheet at the exchange rate prevailing on the original transaction date except where there has been a change in the functional currency (refer to paragraph below).

##### *Group companies*

The results and financial position of all Group entities that have a functional currency different from the presentation currency ("foreign operations") are translated into the presentation currency as follows:

- Assets and liabilities are translated at the closing rate on the balance sheet date;
- Income and expenses are translated at average exchange rates during the period; and
- All resulting exchange differences are recognised as a separate component of equity in the Balance Sheet and included in the Consolidated Statement of Comprehensive Income.

Where there is an unsettled transaction between group companies at the balance sheet date and the monetary asset/(liability) in one group entity is eliminated against the corresponding liability/(asset) in another group entity, the exchange difference reported in the Group entity's own statement of profit or loss continues to be recognised in consolidated profit or loss.

## Notes to the consolidated financial statements

Year ended 31 December 2018

### 2.3 Summary of significant accounting policies (continued)

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as the foreign entity's assets and liabilities and are translated at the closing rate on the balance sheet date.

#### (g) Intangible assets

Intangible assets acquired separately are measured on initial recognition at cost. The cost of intangible assets acquired in a business combination is their fair value as at the date of acquisition. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses. Internally generated intangibles, excluding capitalised development costs, are not capitalised and the related expenditure is reflected in statement of profit or loss in the year in which the expenditure is incurred.

The useful lives of intangible assets are assessed to be either finite or indefinite.

Intangible assets with finite lives are amortised over the useful economic life and assessed for impairment whenever there is an indication that the intangible asset may be impaired. The amortisation period and the amortisation method for an intangible asset with a finite useful life are reviewed at least at each financial year end. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset are considered to modify the amortisation period or method, as appropriate, and are treated as changes in accounting estimates. The amortisation expense on intangible assets with finite lives is recognised in the statement of profit or loss (other operating and administrative expenses).

Intangible assets with finite lives are amortised over:

Insurance contracts intangible assets	8 to 23 years
Insurance policy renewal rights	4 to 5 years
Webware and software development	3 to 5 years
Computer software licences	3 to 5 years

Intangible assets with indefinite useful lives are tested for impairment annually either individually or at the CGU level. Such intangibles are not amortised. The useful life of an intangible asset with an indefinite life is reviewed annually to determine whether indefinite life assessment continues to be supportable. If not, the change in the useful life assessment from indefinite to finite is made on a prospective basis.

Gains or losses arising from de-recognition of an intangible asset are measured as the difference between the net disposal proceeds and the carrying amount of the asset and are recognised in the statement of profit or loss when the asset is derecognised.

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the identifiable assets net of liabilities and contingent liabilities of the acquired entity at the acquisition date. Goodwill is not amortised but is tested annually for impairment and carried at cost less accumulated impairment losses.

Insurance contract intangible assets represent the difference between the fair value of claims provisions purchased from third parties usually as part of a company acquisition. These intangible assets are amortised on a basis consistent with the settlement of the claims. The time value of money, risk margin to unearned premium reserve and other related components of the insurance contract intangible asset run-off at different rates and are amortised according to their respective useful economic lives. The useful economic life of the time value of money component is estimated as eight to twenty three years based on the expected run-off period of the claims arising from the portfolio of business when acquired.

The useful economic life of risk margin to unearned premium reserve and other related components of the insurance contract intangible asset follow the settlement pattern of the related unearned premium reserve and charged/(credited) to underwriting and administrative expenses.

## Notes to the consolidated financial statements

Year ended 31 December 2018

### 2.3 Summary of significant accounting policies (continued)

#### (g) Intangible assets (continued)

Insurance policy renewal rights intangible assets represent the value attributed to future income streams on business acquired where reasonable estimates can be made of the longevity of annually renewable insurance contracts. Renewal rights are valued at fair value at acquisition and amortised on a basis consistent with the estimated retention rates of the business acquired.

Where rights to capacity on a syndicate are acquired from third parties, the cost of acquisition is adopted as the fair value of the associated syndicate participation rights. Where an intangible asset of syndicate participation rights is acquired on a business combination, it is fair valued at the date of acquisition. Syndicate participation rights intangible assets are not amortised but are tested annually for impairment and carried at cost less accumulated impairment losses.

Software development costs that are directly associated with the production of identifiable and unique software products controlled by the Group, and that will generate economic benefits exceeding costs beyond one year, are recognised as intangible assets. Website and software development costs capitalised, including those acquired, are amortised on a straight line basis over their useful economic lives.

Computer software licences acquired, other than through a business combination, are capitalised at cost and amortised on a straight line basis over the shorter of the estimated useful economic life or the duration of the licence agreement.

#### (h) Property and equipment

Property and equipment are stated at historical cost less accumulated depreciation and provision for impairment where appropriate. Depreciation is calculated on a straight line method to write down the cost of assets in equal instalments over their estimated useful lives, at the following annual rates:

Fixtures and fittings	15% to 33.3% per annum
Computer equipment	10% to 33.3% per annum
Motor vehicles	20% to 33.3% per annum
Leasehold improvements	10% to 33.3% per annum

The residual values and useful lives of the assets are reviewed at each balance sheet date and adjusted if appropriate. The carrying values of property and equipment are reviewed for impairment when events or changes in circumstances indicate that the carrying value may be impaired in which event the cost of writing down the asset to a lower valuation is charged to the statement of profit or loss.

Gains and losses on disposals of property and equipment are determined by reference to their carrying value and are taken to the statement of profit or loss. Repairs and renewals are charged to the statement of profit or loss when the expenditure is incurred.

#### (i) Financial assets

The Group classifies its financial assets into the following categories: financial assets at fair value through the statement of profit or loss and loans and receivables.

The classification depends on the purpose for which the investments were acquired. Management determines the classification of its investments at initial recognition.

#### ***Financial assets at fair value through the statement of profit or loss***

The Group classifies its investments at fair value through the statement of profit or loss to the extent that they are not reported as cash and cash equivalents. Financial assets classified into this category are acquired principally for the purpose of managing group liquidity requirements and collateral obligations.

## Notes to the consolidated financial statements

Year ended 31 December 2018

### 2.3 Summary of significant accounting policies (continued)

#### (i) Financial assets (continued)

Purchases and sales of investments are accounted for at their fair values (normally their cost of acquisition or proceeds of disposal) on the trade date, which is the date the Group commits to purchase or sell the assets. The fair value of quoted Investments is based on quoted bid prices.

Unquoted investments are initially carried at cost as the best estimate of fair value, which is adjusted using appropriate valuation techniques and having regard to subsequent events or changes in circumstances.

Realised and fair value gains and losses arising from the changes in fair values are included in investment return in the statement of profit or loss in the period in which they arise.

#### *Loans and receivables*

Loans and receivables include debtors and are non-derivative financial assets with fixed or determinable settlement amounts that are not quoted in an active market, are not intended to be sold in the short term and do not fall into the other categories of financial assets as described above and below. Loans and receivables are initially measured at fair value and subsequently at amortised cost. Appropriate allowances for estimated irrecoverable amounts are recognised in the statement of profit or loss when there is objective evidence that the Group will not be able to collect all amounts due according to their original terms. These are reversed if the amount is collected. Receivables arising from insurance contracts are classified in this category and are reviewed for impairment as part of the impairment review of loans and receivables.

#### *Derivative financial instruments*

Derivatives are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently re-measured at their fair value. Fair values are determined by reference to quoted market prices for similar instruments and using appropriate valuation techniques, including discounted cash flow and options pricing models. The method of recognising the resulting gain or loss depends on whether the derivative is designated as a hedging instrument and, if so, the nature of the item being hedged. For derivatives not formally designated as a hedging instrument, changes in the fair value are recognised immediately in the statement of profit or loss. All derivatives are carried as assets if the fair value is positive and as liabilities if the fair value is negative.

#### *Derecognition of financial assets*

A financial asset (or, when applicable, a part of a financial asset or part of a group of similar financial assets) is derecognised when:

- the rights to receive cash flows from the asset have expired; or
- the Group has transferred its right to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full without material delay to a third party under a 'pass-through' arrangement; and either: (a) the Group has transferred substantially all the risks and rewards of the asset; or (b) the Group has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

When the Group has transferred its right to receive cash flows from an asset or has entered into a pass-through arrangement, and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognised to the extent of the Group's continuing involvement in the asset. In that case, the Group also recognises an associated liability. The transferred asset and the associated liability are measured on a basis that reflects the rights and obligations that the Group has retained.

Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Group could be required to repay.



## Notes to the consolidated financial statements

Year ended 31 December 2018

### 2.3 Summary of significant accounting policies (continued)

#### (j) Financial liabilities

##### *Initial recognition and measurement*

Financial liabilities are classified at initial recognition, as financial liabilities at fair value through profit or loss ("FVPL"), loans and borrowings, payables, or as derivatives designated as hedging instruments in an effective hedge, as appropriate. All financial liabilities are recognised initially at fair value and, in the case of loans and borrowings, net of directly attributable transaction costs.

The Group's financial liabilities include trade and other payables and derivative financial instruments.

##### *Subsequent measurement*

Subsequent measurement of financial liabilities depends on their classification, as follows:

##### *i) Financial liabilities at FVPL*

Financial liabilities at FVPL include financial liabilities held for trading and financial liabilities designated upon initial recognition as at FVPL.

Financial liabilities are classified as held for trading if they are incurred for the purpose of repurchasing in the near term. This category also includes derivative financial instruments entered into by the Group that are not designated as hedging instruments in hedge relationships as defined by IAS 39. Separated embedded derivatives are also classified as held for trading unless they are designated as effective hedging instruments. Financial liabilities are designated as at FVPL at the initial date of recognition, and only if the criteria in IAS 39 are satisfied.

Gains or losses on designated or held for trading liabilities are recognised in fair value gains and losses in the statement of profit or loss.

##### *ii) Interest bearing loans and borrowings*

Borrowings are recognised initially at fair value, net of transaction costs incurred. Borrowings are subsequently stated at amortised cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognised in the statement of profit or loss over the period of the borrowings using the 'effective interest method'.

##### *Derecognition of financial liabilities*

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires. When an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognised in the statement of profit or loss.

#### (k) Offsetting of financial instruments

Financial assets and financial liabilities are offset and the net amount is reported in the consolidated statement of financial position if there is a currently enforceable legal right to offset the recognised amounts and there is an intention to settle on a net basis, to realise the assets and settle the liabilities simultaneously.

#### (l) Derivative financial instruments and hedge accounting

##### *Initial recognition and subsequent measurement*

Derivative financial instruments are classified as held for trading unless they are designated as effective hedging instruments.

**Notes to the consolidated financial statements**

Year ended 31 December 2018

**2.3 Summary of significant accounting policies (continued)****(l) Derivative financial instruments and hedge accounting (continued)**

Derivative financial instruments held for trading are typically entered into with the intention to settle in the near future. The Group uses derivative financial instruments such as forward currency contracts and interest rate swaps to hedge its foreign currency risks and interest rate risks, respectively. Derivative financial instruments are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently remeasured at fair value.

All derivatives are carried as financial assets when the fair value is positive and as financial liabilities when the fair value is negative. Any gains or losses arising from changes in fair value on derivatives are taken directly to profit or loss.

**(m) Fair value measurement**

The Group measures financial instruments such as derivatives, and non-financial assets such as investment properties, at fair value at each reporting date.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either:

- in the principal market for the asset or liability; or
- in the absence of a principal market, in the most advantageous market for the asset or liability.

The principal or the most advantageous market must be accessible by the Group. The fair value of an asset or a liability is measured using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest.

A fair value measurement of a non-financial asset takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use.

The Group uses valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs.

All assets, liabilities and equity items for which fair value is measured or disclosed in the consolidated financial statements are categorised within the fair value hierarchy, described in Note 20.

**(n) Cash and cash equivalents**

Cash and cash equivalents include cash in hand, deposits held at call with banks and other short term highly liquid investments with original maturities of three months or less. These assets are readily convertible into known amounts of cash.

**(o) Taxation**

The tax expense represents the sum of current and deferred tax.

Current tax is determined based on the taxable profit or loss for the year and adjustments to tax payable or recoverable on prior years' profits or losses. The taxable profit or loss differs from the profit or loss before tax as reported in the statement of profit or loss because it excludes items of income or expense that may be taxable or deductible in other years or are expected never to be taxable or deductible. The Group's liability or asset for current tax is calculated using tax rates that have been enacted or substantially enacted by the balance sheet date.

**Notes to the consolidated financial statements**

Year ended 31 December 2018

**2.3 Summary of significant accounting policies (continued)****(o) Taxation (continued)**

Deferred tax is recognised on temporary differences, which are gains or losses that will be taxable in future periods and are not included in the current tax calculation. Deferred tax liabilities are generally recognised for all gains that are not currently taxable but will be taxable in the future. Deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which non-current taxable losses can be deducted. Deferred tax liabilities are recognised for temporary differences arising from investments in subsidiaries and interests in joint ventures, except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and adjusted for changes in estimates of the taxable profits that will be available to allow all or part of the assets to be recovered.

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is expected to settle or the asset is expected to be realised. Deferred tax is charged or credited to the statement of profit or loss, except when it relates to items charged or credited to other comprehensive income or directly to other reserves in equity, in which case the deferred tax is also dealt with in the Statement of Comprehensive Income or directly to other reserves in equity, respectively.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when they relate to taxes levied by the same taxation authority and the Group intends to settle its current tax assets and liabilities on a net basis. Deferred tax assets and liabilities are not discounted for the time value of money.

**(p) Share capital**

Shares are classified as equity when there is no obligation to transfer cash or other assets. There is no scheme for employee owned shares.

**(q) Leases**

Leases in which significantly all the risks and rewards of ownership are transferred to the Group are classified as finance leases. All other leases are treated as operating leases.

At the commencement of the lease term, finance leases are recognised as assets and liabilities at the lower of the fair value of the asset and the present value of the minimum lease payments. The minimum lease payments are apportioned between finance charges and repayments of the outstanding liability, finance charges being charged to each period of the lease term so as to produce a constant rate of interest on the outstanding balance of the liability.

Payments made under operating leases (net of any incentives received from the lessor) are charged to the statement of profit or loss on a straight line basis over the life of the lease.

**(r) Provisions**

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event, and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.

Where the Group expects some or all of a provision to be reimbursed, the reimbursement is recognised as a separate asset, but only when the reimbursement is virtually certain. The expense relating to a provision is presented in the statement of profit or loss net of any reimbursement. If the effect of the time value of money is material, provisions are discounted using a current pre-tax rate that reflects, where appropriate, the risks specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is recognised as a finance cost.

## Notes to the consolidated financial statements

Year ended 31 December 2018

### 2.4 New and amended standards and interpretations

In the current year, the group has applied amendments to IFRSs issued by the IASB that are mandatorily effective for an accounting period that begins on or after 1 January 2018. The new effective requirements are:

- **IFRS 4: Amendment: Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts** (EU effective date: 1 January 2018). The amendments to IFRS 4 issued in 2016 address the accounting consequences of applying IFRS 9 to insurers prior to the adoption of IFRS 17. The amendments include an optional temporary exemption from applying IFRS 9 that is available to companies whose predominant activity is to issue insurance contracts until the earlier of the effective date of IFRS 17 or 2021. The group qualifies for this exemption as at 31 December 2015 \$2,609m or 94% of its total liabilities were connected with insurance. There has been no change in the group's activities since 31 December 2015, therefore the exemption still remains. The group has also disclosed information in relation to specific types of financial instruments to ensure the comparability with the entities applying IFRS 9. As such, fair values are disclosed separately for the group's financial assets which are managed and evaluated on a fair value basis and those which meet the "solely payments of principal and interest" (SPPI) test under IFRS 9. Below is a table outlining the fair value of assets which are managed and evaluated on a fair value basis and those which meet the SPPI test under IFRS 9. The information on credit exposures for debt securities and other fixed income securities and holdings in collective investment schemes can be found in note 32(b) of the financial statements. Certain equity shares, derivative financial instruments and trade and other receivables which are not rated, are considered by the company not to have a low credit risk. For these assets the company value is equal to fair value.

\$'000	2018	2017
<b>Financial assets managed and evaluated on a fair value basis</b>		
Debt securities and other fixed income securities	1,123,747	1,180,715
Holdings in collective investment schemes	802,378	668,029
Equity shares	63,665	40,566
Derivative financial instruments	1,484	3,520
<b>Total financial assets managed and evaluated on a fair value basis</b>	<b>1,991,274</b>	<b>1,892,830</b>
<b>Financial assets meeting the SPPI test</b>		
Trade and other receivables	42,642	43,950
<b>Total financial assets meeting the SPPI test</b>	<b>42,642</b>	<b>43,950</b>

- **IFRS 15: Revenue from Contracts with Customers** (EU effective date: 1 January 2018). The standard replaces IAS 18 and establishes principles for revenue recognition that apply to all contracts with customers except for insurance contracts, financial instruments and lease contracts. It requires an entity to recognise revenue when a customer obtains control of a good or service and thus has the ability to direct the use and obtain the benefits from the good or service. In particular, it specifies that variable consideration is only recognised to the extent that it is highly probable that a significant reversal will not occur. The adoption of this standard has no significant impact on the Group's financial statements, because the point at which control of a performance obligation is transferred to customers matches the point in which risk and rewards were transferred under IAS 18. The retrospective impact of the adoption of IFRS 15 on prior reporting periods is not material to the Group, and prior period comparative figures have not been restated as a result. The adoption of IFRS 15 does not have a significant impact on the Group's consolidated financial statements. Accounting policy 2.3 (e) has been updated to reflect the new requirements.

All revenue under the scope of IFRS 15 relates to fees and commissions as detailed in note 5.

The following new standards, amendments and interpretations, issued but not effective for the financial year beginning 1 January 2018, have not been early adopted:

## Notes to the consolidated financial statements

Year ended 31 December 2018

### 2.4 New and amended standards and interpretations (continued)

- IFRS 9 'Financial Instruments': This standard replaces the guidance in IAS 39. It includes requirements on the classification and measurement of financial assets and liabilities; it also includes an expected credit losses model that replaces the current loss impairment model, and new hedge accounting requirements. Under IFRS 9, all financial assets will be measured at either amortised cost or fair value. The basis of classification depends on the entity's business model and the contractual cash flow characteristics of the financial asset. The hedge accounting requirements are more closely aligned with risk management practices and follow a more principle-based approach. The Group is still assessing the impact of IFRS 9. The temporary exemption has been used.
- IFRS 16 'Leases', replaces IAS 17 and addresses the definition of a lease, recognition and measurement of leases. Lessees will be required to account for all operating leases in a similar manner to the current finance lease accounting recognising lease assets and liabilities on balance sheet. In addition, the current rental charge in the statement of profit or loss will be replaced with a depreciation charge for the lease assets and the interest expense for the lease liabilities. The standard is effective from 1 January 2019. The Group is still assessing the impact to the financial statements, however it intends on applying the modified retrospective approach on transition permitted by IFRS 16. The impact on opening retained earnings is not expected to be material.
- IFRS 17 'Insurance Contracts', which will replace IFRS 4, sets out requirements relating to the measurement, presentation and disclosure of insurance contracts. It prescribes a general measurement model (or building block approach) based on the discounted current estimates of future cash flows including an explicit risk adjustment and a contractual service margin which represents the unearned profit of the contracts. Application of a simplified premium allocation approach, which is similar to the current unearned premium approach, is permitted if it provides a measurement that is not materially different from the general model or if the coverage period is one year or less. IFRS 17 requires any expected losses arising from loss-making contracts to be accounted for in the statement of profit or loss when the entity determines that losses are expected. In November 2018 the IASB recommended an amendment to IFRS 17 to defer the effective date to 1 January 2022. At the same time, they recommended an extension to the fixed expiry date for the temporary exemption for insurers from applying IFRS 9 until 1 January 2022. These amendments are subject to IASB's due process and will be included in an exposure draft expected to be published later in 2019. The Group is evaluating the impact to the financial statements.

### 2.5 Significant accounting judgements, estimates and assumptions

The preparation of the Group's consolidated financial statements requires management to make judgements, estimates and assumptions that affect the reported amounts of revenues, expenses, assets and liabilities, and the accompanying disclosures, and the disclosure of contingent liabilities. Uncertainty about these assumptions and estimates could result in outcomes that require a material adjustment to the carrying amount of assets or liabilities affected in future reporting periods.

Estimates and judgements are continually evaluated and based on historical experience and other factors including expectations of future events that are believed to be reasonable under the circumstances. The most critical accounting estimate made by the Group is the estimate of the ultimate claims liability from insurance contracts underwritten. The estimation of the claims liability is described in Note 2.3 (a).

Gross written premiums include an estimate of the total premiums expected to be received under each insurance and reinsurance contract. Revenue recognised on policies written through contracts with third parties, such as binding authorities and line slips, is estimated in full at the inception of such contracts and, therefore, this estimate is judgmental. Further adjustments to estimates from previous years are also included in the reported premiums for the relevant underwriting years.

Reinstatement premiums are estimated in accordance with the contract terms and recorded based upon paid losses, case reserves and IBNR estimates.

## Notes to the consolidated financial statements

Year ended 31 December 2018

### 2.5 Significant accounting judgements, estimates and assumptions (continued)

Premium estimation uses expert judgement, the quality of the estimate being influenced by the nature and maturity of the portfolio, availability of timely data, relevant underwriting input to the estimating process and management review. Gross written premiums are reviewed regularly using underwriter estimates and actuarial projections.

The Group uses prices provided by third party suppliers, investment managers and counterparty banks in determining the fair value of financial assets. Depending on the methods and assumptions used, for example, in the fair valuation of Level 2 and Level 3 financial assets, the fair valuation can be subject to estimation uncertainty. These methods and assumptions are described in Note 20.

## 3. Group information

### 3.1 Ultimate parent undertaking and controlling party

On 9 March 2018, Sompo Holdings sold its interest in the Canopus group of companies to a private equity consortium led by Centerbridge Partners, L.P. ("Centerbridge").

From the 9<sup>th</sup> March 2018 the immediate parent company of CAG is Fortuna Holdings Limited.

The new ultimate controlling parties of CAG are CCP GP Investors Holdings (Cayman) LP, CCP III Cayman GP Limited and CCP III SBS Cayman GP Limited (acting in concert) along with Gallatin Point (GP) LLC.

### 3.2 Subsidiaries

The principal subsidiaries of Canopus AG, which are consolidated in these financial statements, are listed below. The Group holds no investments in joint ventures or associates and there is no non-controlling interest.

Subsidiary	Country of incorporation	Principal activities	% equity interest	
			2018	2017
Canopus Holdings UK Limited	England and Wales	Holding company	100%	100%
Omega Underwriting Holdings Limited	England and Wales	Holding company	100%	100%
Canopus US Holdings, Inc.	USA (Delaware)	Holding company	100%	100%
Canopus Underwriting Agency Inc.	USA (Delaware)	Insurance company	100%	100%
Canopus US Insurance, Inc.	USA (Delaware)	Insurance company	100%	100%
Canopus Reinsurance AG	Switzerland	Reinsurance company	100%	100%
Canopus Ireland Limited	Ireland	Insurance intermediary	100%	100%
Canopus UK Speciality Limited	England and Wales	Insurance intermediary	100%	100%
Canopus Services Limited	England and Wales	Service company	100%	100%
Canopus Managing Agents Limited	England and Wales	Managing agent at Lloyd's	100%	100%
Canopus Asia Pte. Ltd.	Singapore	Syndicate service company	100%	100%
Canopus Europe Limited	England and Wales	Syndicate service company	100%	100%
Canopus Labuan Pte Limited	Malaysia	Syndicate service company	100%	100%
Canopus Underwriting Bermuda Limited	Bermuda	Syndicate service company	100%	100%
Canopus BV	Netherlands	Syndicate service company	100%	100%
Canopus Underwriting Limited	England and Wales	Syndicate service company	100%	100%
Canopus Capital Two Limited	England and Wales	Lloyd's corporate member	100%	100%
Canopus Capital Four Limited	England and Wales	Lloyd's corporate member	100%	100%
Canopus Capital Five Limited	England and Wales	Lloyd's corporate member	100%	100%
Canopus Capital Seven Limited	England and Wales	Lloyd's corporate member	100%	100%
Canopus Capital Nine Limited	England and Wales	Lloyd's corporate member	100%	100%
Canopus Capital Ten Limited	England and Wales	Lloyd's corporate member	100%	100%
Canopus Capital Eleven Limited	England and Wales	Lloyd's corporate member	100%	100%
Canopus Capital Twelve Limited	England and Wales	Lloyd's corporate member	100%	100%
Canopus Capital Fourteen Limited	England and Wales	Lloyd's corporate member	100%	100%
Flectat Limited	England and Wales	Lloyd's corporate member	100%	100%

**Notes to the consolidated financial statements**

Year ended 31 December 2018

**4. Net premiums**

\$'000	2018	2017
<b>a) Gross premiums on insurance contracts</b>		
Gross premiums written	1,367,777	1,271,233
Change in unearned premiums provision	(55,342)	58,152
Total gross premiums	<u>1,312,435</u>	<u>1,329,385</u>
<b>b) Premiums ceded to reinsurers of insurance contracts</b>		
Reinsurance premiums ceded	(199,642)	(188,840)
Change in unearned premiums provision	21,894	(22,422)
Total premiums ceded to reinsurers	<u>(177,748)</u>	<u>(211,262)</u>
<b>c) Reinsurance to close</b>	<u>76,836</u>	<u>65,883</u>
Net premiums	<u>1,211,523</u>	<u>1,184,006</u>

**5. Fees and commission income**

\$'000	2018	2017
Lloyd's underwriting agencies:		
Management fees	3,147	4,711
Profit commission	-	(1,982)
	<u>3,147</u>	<u>2,729</u>
Insurance services – commission and service fees	6,044	4,806
	<u>9,191</u>	<u>7,535</u>

**6. Investment income**

\$'000	2018	2017
Interest income on financial assets	21,132	21,587
Dividend income	2,281	1,021
Interest income on cash and cash equivalents	14,317	10,145
Gross investment income	<u>37,730</u>	<u>32,753</u>
Investment fees & expenses	(1,759)	(6,398)
Net investment income	<u>35,971</u>	<u>26,355</u>

**7. Net realised gains and losses**

\$'000	2018	2017
Realised gains	13,662	44,861
Realised losses	(23,421)	(45,463)
	<u>(9,759)</u>	<u>(602)</u>

**8. Fair value gains and losses**

\$'000	2018	2017
Fair value gains on other financial assets	32,054	41,151
Fair value losses on other financial assets	(49,884)	(36,095)
	<u>(17,830)</u>	<u>5,056</u>

**Notes to the consolidated financial statements**

Year ended 31 December 2018

**9. Net benefits and claims**

\$'000	2018	2017
<b>a) Gross benefits and claims</b>		
Gross benefits and claims paid	(916,770)	(805,771)
Change in contract liabilities	14,069	(372,438)
	<u>(902,701)</u>	<u>(1,178,209)</u>
<b>b) Reinsurance</b>		
Claims ceded to reinsurers	170,755	99,701
Change in contract liabilities ceded to reinsurers	1,224	167,581
	<u>171,979</u>	<u>267,282</u>
<b>c) Reinsurance to close</b>	<u>(76,836)</u>	<u>(65,883)</u>
Net benefits and claims	<u>(807,558)</u>	<u>(976,810)</u>

**10. Finance costs**

\$'000	2018	2017
Fees for letters of credit	(3,727)	(1,578)
Interest expense	(2)	(122)
Trustee fees and bank charges	(78)	(297)
	<u>(3,807)</u>	<u>(1,997)</u>

**11. Other operating and administrative expenses**

\$'000	Note	2018	2017
Direct commission		(341,027)	(340,199)
Employee benefit expenses	12	(72,056)	(65,280)
Amortisation of intangible assets	14	(7,088)	(5,463)
Impairment of intangible assets	14	-	(6,000)
Depreciation of property and equipment	15	(961)	(1,269)
Operating lease rentals and property costs		(7,431)	(7,820)
Auditor's remuneration - audit & related services		(1,190)	(1,098)
Auditor's remuneration - other services		(267)	(467)
Other expenses		(53,378)	(72,298)
Expenses before exchange adjustments		(483,398)	(499,894)
Net foreign exchange adjustments		(14,088)	11,358
		<u>(497,486)</u>	<u>(488,536)</u>
Underwriting expenses		(450,490)	(466,620)
Non-underwriting expenses		(46,996)	(21,916)
		<u>(497,486)</u>	<u>(488,536)</u>

**12. Employee benefit expenses**

\$'000	2018	2017
Salaries and wages	(58,256)	(54,644)
Social security costs	(6,050)	(6,324)
Pension costs – defined contribution plans	(4,585)	(4,846)
Other benefits	(3,165)	534
	<u>(72,056)</u>	<u>(65,280)</u>

Employee benefits include termination payments of \$1.4 million (2017: \$2.3 million).



**Notes to the consolidated financial statements**

Year ended 31 December 2018

**13. Income tax**

The Company is resident in Switzerland.

The subsidiary companies are registered for tax in various jurisdictions, including the United Kingdom, United States, Switzerland, Singapore, Malaysia, Ireland, the Netherlands and Bermuda. The subsidiary companies in the UK are the main operating and tax-paying companies in the Group. Therefore, as in prior years, it is appropriate to reconcile the Group tax charge to the UK Statutory rate.

Overseas tax primarily relates to US taxes arising from profits generated within the Group's subsidiary companies.

The major components of income tax credit/(expense) for the years ended 31 December 2018 and 2017 are:

**a) Consolidated statement of profit or loss**

\$'000	2018	2017
UK tax:		
Current tax - current year	2,024	(6,535)
- prior year	1,796	(366)
Deferred tax - origination and reversal of temporary differences	(1,273)	10,788
- prior year	629	-
Overseas taxes	8,504	(9,651)
Foreign exchange and other adjustments	(51)	(40)
Total income tax credit/(expense)	<u>11,629</u>	<u>(5,804)</u>

**b) Reconciliation of tax charge**

\$'000	2018	2017
Loss before tax	<u>(75,265)</u>	<u>(238,726)</u>
Tax at 19% (2017: tax rate 19.25%)	14,300	45,955
Losses not subject to tax:		
Losses not subject to UK tax	(4,895)	(10,610)
Overseas taxes	8,504	(9,723)
Prior year adjustments	2,425	(2,522)
Effect of losses not recognised	(8,654)	(28,853)
Other, including effect of change in UK tax rate	(51)	(51)
	<u>11,629</u>	<u>(5,804)</u>

Legislation was passed on 18 November 2015 to reduce the UK corporation tax rate to 19% from 1 April 2017 and 18% from 1 April 2020. Further legislation was introduced in the Finance Bill 2016 to reduce the main rate of corporation tax to 17% from 1 April 2020 (this supersedes the 18% rate). The deferred tax asset has been calculated at 17%, being the rate of corporation tax substantively enacted by the balance sheet date.

**Notes to the consolidated financial statements**

Year ended 31 December 2018

**13. Income tax (continued)****c) Income tax receivable (payable)**

\$'000	2018	2017
At 1 January	(11,730)	(6,677)
UK current tax recorded in the statement of profit or loss	3,820	(6,610)
Overseas taxes recorded in the statement of profit or loss	7,204	(9,755)
Payments made on-account during the year	13,642	10,387
Foreign exchange adjustments	(189)	(177)
Other	103	1,102
At 31 December	<u>12,850</u>	<u>(11,730)</u>

**d) Deferred tax, net**

\$'000	2018	2017
Excess of book over tax depreciation	508	559
Tax on deferred underwriting losses	6,190	6,885
Tax on intangible asset	(3,182)	(3,922)
Other	-	14
Total deferred tax asset	<u>3,516</u>	<u>3,536</u>

Deferred tax assets and liabilities arise through (a) temporary differences in the recognition of underwriting profits/losses for accounting and tax purposes; (b) temporary differences in the recognition of depreciation for accounting and tax purposes; and (c) tax losses which are available to offset future taxable profits

The recoverability of deferred tax assets in relation to underwriting losses will depend on the availability of future taxable profits. Business forecasts indicate it is probable that sufficient profits will accrue within the next five underwriting years

The Group has gross temporary differences of approximately \$256m (2017: \$210m) in respect of trading losses in foreign entities, untaxed underwriting losses in the corporate members and deferred bonuses in UK entities which have no expiry date.

**e) Reconciliation of deferred tax assets/(liabilities), net**

\$'000	2018	2017
Balance at 1 January	3,536	(7,911)
Differences relating to recognition of underwriting results and depreciation:		
- arising during the year	173	3,678
- utilised during the year	740	6,544
Prior year adjustment	(25)	-
Double tax relief in respect of overseas taxes	(886)	886
Foreign exchange and other adjustments	(22)	339
Balance at 31 December	<u>3,516</u>	<u>3,536</u>

## Notes to the consolidated financial statements

Year ended 31 December 2018

## 14. Intangible assets

\$'000	Goodwill	Syndicate participation rights	Insurance contract intangible asset	Insurance policy renewal rights	Website and software development costs	Computer software licences	Total
<b>Cost</b>							
At 1 January 2017	3,664	12,249	25,905	2,637	3,538	5,120	53,113
Additions	-	2,063	-	-	-	-	2,063
Disposals	(3,664)	-	-	(2,871)	(486)	(865)	(7,886)
Exchange	-	-	-	234	40	664	938
Transfer from tangible fixed assets	-	-	-	-	-	1,977	1,977
<b>At 31 December 2017</b>	<b>-</b>	<b>14,312</b>	<b>25,905</b>	<b>-</b>	<b>3,092</b>	<b>6,896</b>	<b>50,205</b>
Additions	-	8,338	-	-	-	-	8,338
Disposals	-	-	-	-	-	(1,047)	(1,047)
Exchange	-	-	-	-	-	(243)	(243)
<b>At 31 December 2018</b>	<b>-</b>	<b>22,650</b>	<b>25,905</b>	<b>-</b>	<b>3,092</b>	<b>5,606</b>	<b>57,253</b>
<b>Accumulated amortisation</b>							
At 1 January 2017	-	-	4,910	2,637	1,829	2,392	11,768
Amortisation in the year	-	-	2,315	-	975	2,173	5,463
Disposals	-	-	-	(2,871)	(485)	-	(3,356)
Impairment	-	-	6,000	-	-	-	6,000
Exchange	-	-	-	234	39	509	782
Transfer from tangible fixed assets	-	-	-	-	-	(1,012)	(1,012)
<b>At 31 December 2017</b>	<b>-</b>	<b>-</b>	<b>13,225</b>	<b>-</b>	<b>2,358</b>	<b>4,062</b>	<b>19,645</b>
Amortisation in the year	-	-	4,324	-	734	2,030	7,088
Disposals	-	-	-	-	-	(1,047)	(1,047)
Exchange	-	-	-	-	-	(131)	(131)
<b>At 31 December 2018</b>	<b>-</b>	<b>-</b>	<b>17,549</b>	<b>-</b>	<b>3,092</b>	<b>4,914</b>	<b>25,555</b>
<b>Carrying amount</b>							
At 31 December 2017	-	14,312	12,680	-	734	2,834	30,560
At 31 December 2018	-	22,650	8,356	-	-	692	31,698

**Intangible assets with an indefinite useful life**

Goodwill and syndicate participation rights are deemed to have indefinite useful life as they are expected to have value in use that does not erode or become obsolete over the course of time. Consequently, they are not amortised but annually tested for impairment in relation to the business units from where or for which they were acquired. The impairment review uses projected cash flows, expected profitability and an internal assessment of business retention based on 8 year financial projections and a longer term assumed growth rate of 2%. This has been discounted at a risk adjusted discount rate of 15.3% representing a risk-free rate and an additional prudent margin. There was no impairment indication of syndicate participation rights in 2018. The valuation of the syndicate participation rights intangible is sensitive to the key assumptions of business growth, profitability and risk adjusted discount rate, which are judgmental and based on management's best estimate at the balance sheet date. Reasonably alternative assumptions could potentially result in an impairment in the carrying value of this intangible.

The goodwill held, at the start of 2017, related to the acquisition of Canopus UK Specialty Limited of which the trade and assets were sold to a third party during 2017 therefore the goodwill was deemed to be wholly disposed of during that year.

**Intangible assets with a finite useful life**

The insurance contract intangible, insurance policy renewal rights, website and software development costs and computer licences are amortised over their finite economic lives and the charge is included in other operating and administrative expenses in the consolidated statement of profit or loss.

**Notes to the consolidated financial statements**

Year ended 31 December 2018

**14. Intangible assets (continued)**

The time value of money, risk margin to unearned premium reserve and other related components of the insurance contract intangible asset run-off at different rates and are amortised according to their respective useful economic lives. The useful economic life of the time value of money component is estimated as eight to twenty three years based on the expected run-off period of the claims arising from the portfolio of business when acquired. There was no impairment indication in 2018 (2017: \$6m).

The remaining assets with finite useful life were tested for impairment at the respective year ends and no impairment was deemed necessary.

**15. Property and equipment**

	Note	Computer equipment	Motor vehicles	Fixtures, fittings and equipment	Leasehold improvements	Total
\$'000						
<b>Cost</b>						
At 1 January 2017		19,181	239	3,609	5,638	28,667
Additions		504	105	110	-	719
Disposals		(637)	(176)	(263)	(122)	(1,198)
On disposal of a business		(52)	-	(446)	(513)	(1,011)
Transferred to intangible fixed assets		(1,977)	-	-	-	(1,977)
Exchange		1,496	40	266	433	2,235
<b>At 31 December 2017</b>		<b>18,515</b>	<b>208</b>	<b>3,276</b>	<b>5,436</b>	<b>27,435</b>
Additions		99	-	16	-	115
Disposals		(12,620)	(165)	(754)	(3,783)	(17,322)
Exchange		(1,140)	72	(111)	(277)	(1,456)
<b>At 31 December 2018</b>		<b>4,854</b>	<b>115</b>	<b>2,427</b>	<b>1,376</b>	<b>8,772</b>
<b>Accumulated depreciation</b>						
At 1 January 2017		14,726	78	2,305	5,013	22,122
Charge for the year	11	731	48	426	64	1,269
Disposals		(41)	(122)	(229)	(36)	(428)
On disposal of a business		(91)	-	(158)	(130)	(379)
Transferred to intangible fixed assets		1,012	-	-	-	1,012
Exchange		1,480	22	176	379	2,057
<b>At 31 December 2017</b>		<b>17,817</b>	<b>26</b>	<b>2,520</b>	<b>5,290</b>	<b>25,653</b>
Charge for the year	11	523	33	388	17	961
Disposals		(12,620)	(127)	(754)	(3,783)	(17,284)
Exchange		(1,016)	85	(97)	(266)	(1,294)
<b>At 31 December 2018</b>		<b>4,704</b>	<b>17</b>	<b>2,057</b>	<b>1,258</b>	<b>8,036</b>
<b>Carrying amount</b>						
At 31 December 2017		698	182	756	146	1,782
At 31 December 2018		150	98	370	118	736

**Notes to the consolidated financial statements**

Year ended 31 December 2018

**16. Deferred acquisition costs**

\$'000		2018	2017
Insurance contract deferred acquisition costs at 1 January		158,951	176,984
Movement in deferred acquisition costs		26,011	(18,033)
Insurance contract deferred acquisition costs at 31 December		<u>184,962</u>	<u>158,951</u>

**17. Reinsurance assets**

\$'000	Note	2018	2017
Non-life:			
Reinsurers' share of outstanding claims provision	26 i	269,227	232,448
Reinsurers' share of incurred but not reported provision	26 ii	276,200	334,374
Reinsurers' share of claims outstanding		<u>545,427</u>	<u>566,822</u>
Reinsurers' share of unearned premiums	26 iii	66,206	44,162
		<u>611,633</u>	<u>610,984</u>

**18. Financial assets****a) Financial assets at fair value through profit or loss**

\$'000		2018	2017
Fair value (designated as such upon initial recognition)			
Debt securities and other fixed income securities		1,123,747	1,180,715
Holdings in collective investment schemes		802,378	668,029
Equity shares		63,665	40,566
Total financial assets at fair value through profit or loss		<u>1,989,790</u>	<u>1,889,310</u>

Financial assets which are subject to restrictions are referred to in Note 34(a).

**b) Carrying value of financial instruments other than derivatives**

\$'000		2018	2017
Fair value (designated as such upon initial recognition)			
At 1 January		1,889,310	1,914,463
Purchases		1,367,177	1,068,190
Disposals		(1,248,867)	(1,098,399)
Fair value (losses)/profits in the statement of profit or loss		(17,830)	5,056
At 31 December		<u>1,989,790</u>	<u>1,889,310</u>

## Notes to the consolidated financial statements

Year ended 31 December 2018

### 19. Derivative financial instruments

The Group utilises derivative financial instruments as part of its asset/liability risk management practice.

The derivative financial instruments represent the fair value of exchange traded bond futures contracts used to hedge duration risk, and forward contracts used to hedge excess foreign currency exposures. The derivative financial instruments held by the Group have not been designated for hedge accounting during the current and previous financial years as permitted by IAS 39.

The following table shows the fair value through profit or loss ("FVPL") of derivative financial instruments, recorded as assets or liabilities, together with their notional amounts. The notional amount, recorded gross, is the amount of a derivative's underlying assets, reference rate or index and is the basis upon which changes in the value of derivatives are measured. The notional amounts indicate the volume of transactions outstanding at the year-end and are indicative of neither the market risk nor the credit risk.

	2018			2017		
	Assets	Liabilities	Notional amount	Assets	Liabilities	Notional amount
\$'000						
Derivatives at FVPL:						
Interest rate futures	340	(105)	27,811	53	(100)	58,000
Forward exchange forward contracts	1,129	(195)	394,638	3,467	(1,001)	385,705
Interest rate options	15	(689)	122,018	-	-	-
Credit default swaps	-	-	-	-	(3,475)	150,000
	<u>1,484</u>	<u>(989)</u>	<u>544,467</u>	<u>3,520</u>	<u>(4,576)</u>	<u>593,705</u>

At their inception, derivatives often involve only a mutual exchange of promises, with little or no transfer of consideration. However, these instruments frequently involve a high degree of leverage and are very volatile. A relatively small movement in the value of the asset, rate or index underlying a derivative contract may have a significant impact on the profit or loss of the Group. Over-the-counter derivatives may expose the Group to the risks associated with the absence of an exchange market on which to close out an open position. The Group's exposure under derivative contracts is closely monitored as part of the overall management of the Group's market risk.

## Notes to the consolidated financial statements

Year ended 31 December 2018

### 20. Fair value measurement

#### i) Valuation

The Group has classified its financial instruments as at 31 December 2018 using the fair value hierarchy required by IFRS 13 'Fair value measurement'. The fair value hierarchy classifies financial instruments into Level 1 to Level 3 based on the significance of the inputs used in measuring their fair value, with Level 1 considered the most reliable. The levels within the fair value hierarchy are defined as follows:

- Level 1 - Quoted prices (unadjusted) in active markets for identical assets or liabilities.
- Level 2 - Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices).
- Level 3 - Valuation techniques for which inputs are not based on observable market data.

The fair value of financial instruments traded in active markets is based on quoted bid prices at the balance sheet date and are included in Level 1.

The Group closely monitors the valuation of assets in markets that have become less liquid. Determining whether a market is active requires the exercise of judgement and is determined based upon the facts and circumstances of the market for the instrument being measured. Where it is determined that there is no active market, fair value is established using a valuation technique. The techniques applied incorporate relevant information available and reflect appropriate adjustments for credit and liquidity risks. These valuation techniques maximise the use of observable market data where it is available and rely as little as possible on entity specific estimates. If all significant inputs required to fair value an instrument are observable, the instrument is included in Level 2.

If one or more significant inputs are not based on observable market data, the instrument is included in Level 3. These assets are normally infrequently traded and fair values can only be calculated using estimates or risk-adjusted value ranges and there is a material use of judgement in deriving the price.

#### ii) Fair value measurement of assets

\$'000	Level 1	Level 2	Level 3	Total
<b>Valuation at 31 December 2018</b>				
Debt securities & other fixed income securities	538,227	585,520	-	1,123,747
Holdings in collective investment schemes	128,673	673,705	-	802,378
Equity	63,665	-	-	63,665
Financial assets	730,565	1,259,225	-	1,989,790
Derivatives	340	1,144	-	1,484
	<u>730,905</u>	<u>1,260,369</u>	<u>-</u>	<u>1,991,274</u>
\$'000	Level 1	Level 2	Level 3	Total
<b>Valuation at 31 December 2017</b>				
Debt securities & other fixed income securities	958,163	222,552	-	1,180,715
Holdings in collective investment schemes	214,199	453,830	-	668,029
Equity	40,566	-	-	40,566
Financial assets	1,212,928	676,382	-	1,889,310
Derivatives	1,526	1,994	-	3,520
	<u>1,214,454</u>	<u>678,376</u>	<u>-</u>	<u>1,892,830</u>

**Notes to the consolidated financial statements**

Year ended 31 December 2018

**20. Fair value measurement (continued)**

The level within the hierarchy that a financial instrument is placed is based on the lowest level of any input that is significant to its fair value measurement. In the current year corporate bonds of \$333m have been classified as level 2, which were classified as level 1 in the prior year. Quoted prices for corporate bonds are based on a limited number of transactions for those securities and as such are considered to meet the definition of level 2 assets.

At 31 December 2018 and 31 December 2017 there were no securities classified as Level 3 under IFRS.

In 2018, the sensitivity of level 3 measurements to favourable and unfavourable changes has not been considered as there were no level 3 investments.

Any reclassification between categories is deemed to take place at the reporting year end.

**21 Insurance receivables**

\$'000	2018	2017
Debtors arising out of insurance operations	524,135	509,364
Debtors arising out of reinsurance operations	94,377	127,320
	<u>618,512</u>	<u>636,684</u>
Amounts due within 1 year	618,199	636,095
Amounts due in over 1 year	313	589
	<u>618,512</u>	<u>636,684</u>

Debtors arising out of insurance operations are receivable within one year and relate to business transacted with brokers and intermediaries. Debtors arising out of reinsurance operations comprise amounts receivable from reinsurers in respect of paid claims and brokers' balances receivable on inwards reinsurance business. All insurance receivables are designated as loans and receivables and their carrying values approximate fair value at the reporting date.

**22. Trade and other receivables**

\$'000	2018	2017
Loan	13,500	13,500
Other debtors	16,449	14,395
Accrued income	12,693	16,055
	<u>42,642</u>	<u>43,950</u>
Amounts due within 1 year	31,842	30,450
Amounts due in over 1 year	10,800	13,500
	<u>42,642</u>	<u>43,950</u>

The fair value of trade and other receivables approximate to their carrying value.

The loan principal \$13.5m, which is repayable in five equal annual instalments of \$2.7m commencing in 2019, and accrued interest thereon of \$0.1m, was tested by management for impairment at 31 December 2018 and management concluded that no impairment is required.



**Notes to the consolidated financial statements**

Year ended 31 December 2018

**23. Cash and cash equivalents**

\$'000	2018	2017
Cash at bank and in hand	<u>165,563</u>	<u>245,384</u>
	<u>165,563</u>	<u>245,384</u>

Cash and cash equivalents are held at carrying value as it is a reasonable approximation of their fair value.

Overseas deposits in 2018 of \$50.8m and 2017 of \$67m have been reclassified from cash and cash equivalents to other assets.

The cash and cash equivalents include \$109.2 million (2017: \$82.0 million) that are held in Lloyd's Premium and other trust funds supporting insurance liabilities. These assets are subject to restrictions under the relevant trust deeds and bank facilities.

**24. Share capital****Authorised, issued and fully paid:**

	At 31 December 2017 number	Changes in Issued capital number	At 31 December 2018 number
Ordinary shares of 1CHF par value	<u>100,000</u>	-	<u>100,000</u>
<b>Ordinary shares total</b>	<u>100,000</u>	-	<u>100,000</u>
<b>Share capital</b>	<u>\$105,719</u>		<u>\$105,719</u>

**25. Insurance contract liabilities**

\$'000	Note	2018	2017
Non-life:			
Outstanding claims provision	26 i	1,285,387	1,175,949
Incurred but not reported provision	26 ii	<u>861,848</u>	<u>1,005,175</u>
Claims outstanding		2,147,235	2,181,124
Provision for unearned premiums	26 iii	<u>563,067</u>	<u>508,050</u>
		<u>2,710,302</u>	<u>2,689,174</u>

**26. Insurance contract liabilities and reinsurance assets****i. Outstanding claims provision**

\$'000	2018			2017		
	Insurance contract liabilities	Reinsurance of liabilities	Net	Insurance contract liabilities	Reinsurance of liabilities	Net
Non-life:						
At 1 January	1,175,949	(232,448)	943,501	956,450	(246,089)	710,361
Movement during the year	120,072	(62,875)	57,197	169,000	8,934	177,934
Exchange and other adjustments	(10,634)	26,096	15,462	50,499	4,707	55,206
At 31 December	<u>1,285,387</u>	<u>(269,227)</u>	<u>1,016,160</u>	<u>1,175,949</u>	<u>(232,448)</u>	<u>943,501</u>

## Notes to the consolidated financial statements

Year ended 31 December 2018

## 26. Insurance contract liabilities and reinsurance assets (continued)

## ii. Incurred but not reported provision

\$'000	2018			2017		
	Insurance contract liabilities	Reinsurance of liabilities	Net	Insurance contract liabilities	Reinsurance of liabilities	Net
Non-life:						
At 1 January	1,005,175	(334,374)	670,801	772,422	(188,479)	583,943
Movement during the year	(134,141)	61,651	(72,490)	203,438	(176,515)	26,923
Exchange and other adjustments	(9,186)	(3,477)	(12,663)	29,315	30,620	59,935
At 31 December	<u>861,848</u>	<u>(276,200)</u>	<u>585,648</u>	<u>1,005,175</u>	<u>(334,374)</u>	<u>670,801</u>

It is estimated, using historical settlement trends, that \$751 million (2017: \$696 million) of the gross claims outstanding and incurred but not reported provision and \$201 million (2017: \$357 million) of the corresponding amount recoverable from reinsurers included in the above analyses, will settle in the next 12 months.

## iii. Provision for unearned premiums

\$'000	2018			2017		
	Insurance contract liabilities	Reinsurance of liabilities	Net	Insurance contract liabilities	Reinsurance of liabilities	Net
Non-life:						
At 1 January	508,050	(44,162)	463,888	566,025	(66,561)	499,464
Movement during the year	55,342	(21,894)	33,448	(58,152)	22,422	(35,730)
Other adjustments	(325)	(150)	(475)	177	(23)	154
At 31 December	<u>563,067</u>	<u>(66,206)</u>	<u>496,861</u>	<u>508,050</u>	<u>(44,162)</u>	<u>463,888</u>

## 27. Insurance payables

\$'000	2018	2017
Creditors arising out of insurance operations	140,325	119,398
Creditors arising out of reinsurance operations	<u>124,443</u>	<u>211,069</u>
	<u>264,768</u>	<u>330,467</u>

Creditors arising out of reinsurance operations comprise principally premiums payable for reinsurance, including reinstatement premiums and corporate member level quota share reinsurance premiums payable.

## 28. Trade and other payables

\$'000	2018	2017
Other creditors including taxation and social security	21,963	44,312
Accruals and deferred income	<u>34,368</u>	<u>40,544</u>
	<u>56,331</u>	<u>84,856</u>

**Notes to the consolidated financial statements**

Year ended 31 December 2018

**29. Pension benefit obligations**

The Group operates defined contribution pension plans for its employees in the United Kingdom as well as a closed defined benefit pension scheme for certain of its former employees. The assets of the plans and the scheme are held separately from those of the Group companies in independently administered funds. Pension entitlements of employees outside the United Kingdom are provided through state schemes, to which the Group contributes in accordance with local regulations.

**i) Defined benefit scheme**

The defined benefit pension scheme ("the scheme") was closed with effect from 30 June 2010 and all active members were treated as having left pensionable service under the scheme with effect from that date. A valuation of the scheme was undertaken at 31 December 2018 by a qualified independent actuary.

The principal actuarial assumptions at the balance sheet date (expressed as weighted averages) were as follows:

	<b>2018</b>	<b>2017</b>
	% per annum	% per annum
Discount rate	2.9	2.4
Expected long-term rate of return of scheme assets	2.5	2.4
Increase in salaries	n/a	n/a
Inflation assumptions	3.2	3.1
LPI pension increases (capped at 5% per annum)	3.2	3.1

The underlying mortality assumption is based upon the standard table known as S2LPA CMI 2017, subject to a minimum annual rate of future improvement of 1% per annum.

The scheme is operated by Canopus Services Limited, a subsidiary of the Group and current sponsor of the scheme. At 31 December 2018 the present value of the scheme liabilities (in \$'000) was \$12,847 (2017: \$14,861) and the market value of scheme assets was \$13,604 (2017: \$15,371), giving a surplus of \$757 (2017: surplus of \$510) calculated in accordance with the requirements of accounting standards.

The surplus was calculated based on the above assumptions in compliance with the requirements of accounting standards. The surplus is not recognised in the accounts on the basis that it is not considered probable that it will be recovered by the scheme. The latest triennial valuation prepared by the scheme Actuary as at 1 January 2016 on behalf of the Trustees of the scheme concluded the scheme was adequately funded. The next triennial valuation will be as at 1 January 2019.

As the scheme is considered not material in the context of the Group, reduced disclosure is given in this note.

**ii) Defined contribution plans**

The level of contributions for the defined contribution plans generally varies between 10% to 25% of salaries. Contributions (in \$'000) of \$360 (2017: \$237) in respect of the plans were outstanding at the year end and are included in other creditors including taxation and social security. These were settled in the month following the year end.

**Notes to the consolidated financial statements**

Year ended 31 December 2018

**30. Cash generated from operating activities**

\$'000	2018	2017
<b><i>Net change in operational assets</i></b>		
Net change in reinsurance assets	(649)	(109,855)
Net change in insurance receivables	18,173	(26,743)
Net change in other assets	15,007	25,231
Total	<u>32,531</u>	<u>(111,367)</u>
<b><i>Net change in operational liabilities</i></b>		
Net change in non-life insurance contract liabilities	(65,498)	332,897
Net change in insurance payables	20,927	13,251
Net change in other liabilities	<u>(27,536)</u>	<u>(32,878)</u>
Total	<u>(72,107)</u>	<u>313,270</u>

The Group classifies the cash flows from the acquisition and disposal of financial assets as investing cash flows, as the purchases are funded from the net cash flows associated with the origination of insurance and investment contracts and the payment of benefits and claims incurred for insurance and investment contracts, which are respectively treated under investing activities.

**31. Risk management framework****a. Governance framework**

The primary objective of the Group's risk and financial management framework is to protect the Group's shareholders from events that hinder the sustainable achievement of financial performance objectives, including failing to exploit opportunities. Management recognises the critical importance of having efficient and effective risk management systems in place.

The Group has established a risk management function with clear terms of reference from the board of directors, its committees and the associated executive management committees. This is supplemented with a clear organisational structure with documented delegated authorities and responsibilities from the board of directors to executive management groups and senior managers. Lastly, a Group policy framework, which sets out the risk policies for the Group, risk management, control and business conduct standards for the Group's operations, are in place. Each policy has a member of senior management charged with overseeing compliance with the policy throughout the Group.

The Board of directors approves the Group's risk management policies and meets regularly to approve any commercial, regulatory and organisational requirements of such policies. These policies define the Group's identification of risk and its interpretation, limit its structure to ensure the appropriate quality and diversification of assets, align underwriting and reinsurance strategy to the corporate goals, and specify reporting requirements.

**b. Capital management objectives, policies and approach**

The Group has established the following capital management objectives, policies and approach to manage the risks that affect its capital position:

- Maintaining the required level of stability of the Group thereby providing a degree of security to policyholders;
- Allocating capital efficiently and support the development of business by ensuring that returns on capital employed meet the requirements of its capital providers and shareholders;
- Retaining financial flexibility by maintaining strong liquidity and access to a range of capital markets;
- Aligning the profile of assets and liabilities taking account of risks inherent in the business;
- Maintaining financial strength to support new business growth and to satisfy the requirements of the policyholders, regulators and stakeholders; and

## Notes to the consolidated financial statements

Year ended 31 December 2018

### 31. Risk management framework (continued)

#### b. Capital management objectives, policies and approach (continued)

- Maintain strong credit ratings and healthy capital ratios in order to support its business objectives and maximise shareholders value.

#### c. Regulatory framework

The operations of the Group are also subject to regulatory requirements within the jurisdictions in which it operates. Such regulations not only prescribe approval and monitoring of activities, but also impose certain restrictive provisions (e.g. capital adequacy) to minimise the risk of default and insolvency on the part of the insurance companies to meet unforeseeable liabilities as they arise. The Group's capital management policy for its insurance and non-insurance business is to hold sufficient capital to cover the statutory requirements, including any additional amounts required by the regulator.

For the Syndicates, through which the Group writes business, the Prudential Regulation Authority ("PRA") and Lloyd's oversee a capital regime that requires companies to calculate their own capital requirements under Solvency II through a Solvency Capital Requirement ("SCR"). Capital models are maintained in accordance with this regime.

The Swiss regulators, FINMA, oversee capital adequacy for Canopus Reinsurance AG (formerly Somp Japan Canopus Reinsurance AG) ("CRe"). CRe must calculate and submit a yearly Swiss based capital requirement in accordance with FINMA, the Swiss Solvency Test ("SST") requirement.

For CRe, the Target Capital ("TC") under the Swiss Solvency Test ("SST") represents the capital requirement under Swiss regulations. In addition to the Swiss regulatory requirements, CRe is required to meet any branch regulatory capital and return requirements.

Canopus US Insurance, Inc. ("CUS") is domiciled in the state of Delaware and is required to maintain capital and surplus determined by the minimum under the Delaware Insurance Code of \$500,000. In Delaware, CUS is eligible to write on an admitted basis and a surplus lines basis as it is licensed as a Domestic Surplus Lines Insurer. In addition to its Delaware licence, CUS is eligible to write business on a non-admitted or surplus lines basis in the other 49 states and the District of Columbia. These jurisdictions have varying minimum capital and surplus requirements to maintain eligibility. The state of New York has the largest minimum requirement at \$46 million. This requirement increases to \$47m on 1<sup>st</sup> January 2019.

The Group and regulated entities within it have met all of these requirements throughout the financial year.

#### d. Approach to capital management

The Group seeks to optimise the structure and sources of capital to ensure that it consistently maximises returns to the shareholders and policyholders.

The Group's approach to managing capital involves managing assets, liabilities and risks in a coordinated way, assessing shortfalls between reported and required capital levels (by each regulated entity) on a regular basis and taking appropriate actions to influence the capital position of the Group in the light of changes in economic conditions and risk characteristics. An important aspect of the Group's overall capital management process is the setting of target risk adjusted rates of return, which are aligned to performance objectives and ensure that the Group is focused on the creation of value for shareholders.

The Group uses equity, unsecured letters of credit and reinsurance for its capital needs and seeks to optimise the mix in order to maximise profits for a level of gearing consistent with the Group's risk appetite and the regulatory and market requirements of its business.

**Notes to the consolidated financial statements**

Year ended 31 December 2018

**31. Risk management framework (continued)****d. Approach to capital management (continued)**

The capital requirements are routinely forecast on a periodic basis and assessed against both the forecast available capital and the expected internal rate of return, including risk and sensitivity analyses. The process is ultimately subject to approval by the Board.

The historic c. \$1 billion worth of Japanese letters of credit that were in place under Sompo's ownership has been terminated in 2018 following the change of ownership. The Group has entered into a new \$250m letter of credit facility led by ING Bank, of which \$237.5m is being utilised.

Available capital resources

\$'000	2018	2017
Total equity	681,797	570,898
Unsecured letters of credit facilities	237,542	703,091
	<u>919,339</u>	<u>1,273,989</u>

**e. Asset liability management (ALM) framework**

Financial risks associated with the balance sheet arise from mismatches in our interest rate, currency and equity exposures, all of which are exposed to fluctuations in market variables. The Group's key ALM strategic objectives supported by the ALM framework are to manage asset liability mis-matches to maximise returns on capital while ensuring that adequate levels of liquidity remain at all times especially in adverse market conditions.

The ALM framework ensures the right balance of assets to liabilities is maintained to ensure solvency across several currencies. Assets and liabilities are to be "broadly matched" and managed within the Group Board and entity Board approved tolerance thresholds. An integral part of the ALM framework is to ensure we hold assets that can be readily converted if required to deal with unexpected cash outflows or changes in expected cash flows to ensure financial resources are maintained to meet liabilities as they fall due.

**32. Management of insurance and financial risk****Risk governance**

The cornerstone of the Group's risk management process is the development and embedding into 'business as usual practice' of a strong risk management and control culture supported by an enterprise wide set of policies and practices.

The Group operates a "Three Lines of Defence" risk governance model.

The first line of defence involves everyone involved in day-to-day risk taking and comprises all underwriting and operational areas. The first line has direct responsibility for the management and control of risk.

The first line of defence involves all members of staff at every level within the business who are responsible for identifying, taking and managing risk in their area.

The second line of defence includes the Risk and Compliance functions that provide oversight and challenge to the first line of defence.

## Notes to the consolidated financial statements

Year ended 31 December 2018

### 32. Management of insurance and financial risk (continued)

#### Risk governance (continued)

Risk reporting is performed by the Risk function, which routinely engages with individual business units and reports to the Boards and their sub-committees. Functional risk reporting is escalated through the group structure to the Boards e.g. Syndicates 4444 aggregate information is collated, analysed and reported by a central catastrophe management team to the Group Underwriting Committee. The Active Underwriter reports aggregate information to the Board of Canopus Managing Agents Limited.

The third line of defence principally involves the Group's independent Internal Audit function.

#### Risk appetite

Risk appetite is the articulation of the amount of risk from all sources that the Group is prepared to accept to meet its strategic objectives. It is determined with consideration of its philosophy towards risk taking and its financial and operational capacity, while at the same time recognising the need to generate returns on capital that are in line with shareholder requirements.

The Board has responsibility for ensuring the effective management and control of risk. Accordingly, the Board approves the Enterprise Risk Management Framework and risk appetite in line with the business plan.

When apportioning the overall risk appetite to different categories of risk the Group considers whether there is potential reward for the assumption of the risk and the ability to manage the quantum of the risk directly and the timeframe over which this can be achieved.

Risks are taken that are aligned to the Group's strategic objectives and it has the organisational capability to monitor and control. Risks are not taken that will expose the Group to an unacceptable level of operational risk or risk to the reputation and brand.

The Group's core business is the underwriting of (re)insurance and so the risk appetite is primarily focussed on insurance risk. However, returns on investments can also make a positive contribution to profit and so there is some appetite for market risk. Other risks are not expected to contribute to profit but are inherent in the business operations. There is therefore some limited appetite for credit, liquidity and operational risks – but for these risks the focus is primarily on risk mitigation through the control framework.

Where possible, the risk appetite has been articulated into clearly defined quantitative measures. Risks are then monitored and reported against these defined risk tolerances.

The Board receives quarterly reports highlighting where the risk profile sits relative to the risk tolerances. If at any stage a risk breaches the agreed tolerance, the Board will be informed and appropriate remedial action will be taken to bring the risk with agreed levels.

#### Risk control

The Group's approach to risk management is supported by risk controls, which include the development and communication of policies, establishment of formal risk assessment and approval processes, and the establishment of delegated authorities and limits. The implementation of robust risk controls is designed to enable the optimisation of risk and return on both a portfolio and a transactional basis.

## Notes to the consolidated financial statements

Year ended 31 December 2018

### 32. Management of insurance and financial risk (continued)

#### Risk categories

In the normal course of business, the Group is exposed to many risks and differentiates between them using the following major risk categories:

Insurance Risk	Risk of loss arising from inherent uncertainties as to the occurrence, amount and timing of insurance liabilities and premiums;
Operational Risk	Risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events;
Financial Risk	Risks relating to market, credit and liquidity as follows:
(a) Market Risk	Risk of loss resulting, directly or indirectly, from fluctuations in the level and in the volatility of market prices of assets, liabilities and financial instruments;
(b) Credit Risk	Risk of loss arising as a result of another party failing to perform its financial obligations or failing to perform them in a timely fashion;
(c) Liquidity Risk	Risk that insufficient liquid financial resources are maintained to meet liabilities as they fall due;
Capital Risk	Risk of loss arising from inappropriate levels or sources of capital;
Strategic Risk	Risk of making wrong business decisions, implementing decisions poorly, managing capital inadequately, or being unable to adapt to changes in the operating environment;

#### Risk policies

Risk policies are in place for the major risk categories.



## Notes to the consolidated financial statements

Year ended 31 December 2018

### 32. Management of insurance and financial risk (continued)

#### Risk assessment

Risk identification exercises help focus attention on the highest priority risks and help minimise the likelihood of any surprises. All risks identified are assessed and reassessed on a "potential probability of occurrence and exposure impact" basis. The controls in place to mitigate risk are regularly assessed to ensure they are operating effectively.

Where control performance issues or control enhancements are identified, a remedial action plan is implemented. A self-assessment process is undertaken on a regular basis and signed off by risk and control owners. Internal Audit also reviews and tests the adequacy and effectiveness of controls documented during the self-assessment process and reports to the Audit Committee.

#### Reporting

Risk monitoring and reporting is considered to be a critical component of the risk management process and supports the ability of senior management and the Boards to effectively perform their risk management and oversight responsibilities.

Regular internal reporting is provided to senior management and the Boards including (but not limited to); risk appetite monitoring, key risk indicators, risk and control assessments/ Internal Control Framework, stress and scenario testing, emerging risk reporting, Own Risk and Solvency Assessments.

External reporting is provided as required by law and other relevant regulations. Regular reporting on risks is provided to stakeholders including regulators and external ratings agencies.

#### Insurance risk

There is a significant risk attached to ineffective management of insurance and related activities. The principal areas of risk arise from:

- Inappropriate underwriting activities and cycle management;
- Fluctuations in the timing, frequency and severity of claims and claims settlements relative to expectations;
- Inadequate or insufficient reinsurance protection;
- Inadequate catastrophe exposure management;
- Ineffective controls over coverholders; and
- Inadequate reserves.

#### Insurance risk appetite and tolerance

The taking of controlled risk and the exploring of new underwriting opportunities is encouraged, provided that the resultant exposures are within the insurance risk appetite and tolerances set by the Group. The Group looks to maximise returns throughout the underwriting cycle, which may result in increasing exposures in certain lines of business, whilst reducing exposures in others.

The Board seeks to mitigate insurance risk by analysing historical pricing and claims experience, setting a tolerance to concentration risk, monitoring performance, and conducting in-house actuarial review of claims provisions, independent of the underwriting teams.

The Group has formal controls in place to ensure that business is underwritten in a controlled environment by reference to both the annual business plan and in line with underwriting policy. Preventative controls include Underwriting Authority Limits which are agreed and signed off by the Active Underwriter, Divisional and Group Underwriting Guidelines and benchmark ratings for all underwriting divisions. Detection controls include exception reports where authority limits are exceeded, expert review procedures, peer reviews, monthly management meetings and reviews by 'internal audit'.

## Notes to the consolidated financial statements

Year ended 31 December 2018

### 32. Management of insurance and financial risk (continued)

#### *Underwriting*

The Group accepts insurance risk in a range of classes of business through its insurance underwriting entities: Syndicate 4444, Canopus Reinsurance AG (formerly Sampo Japan Canopus Reinsurance AG) ("CRe") and Canopus US Insurance, Inc. The Group owns a number of underwriting service companies and insurance intermediaries in Bermuda, Ireland, Singapore, Malaysia, Switzerland, the Netherlands and the UK.

The Group's underwriting strategy is to seek a diverse and balanced portfolio in order to limit the variability of outcomes. This is achieved by accepting a spread of business, segmented into different classes.

The annual business plan for each underwriting team reflects the Group's underwriting strategy, and sets out the classes of business, the territories and the industry sectors in which the Group is prepared to accept exposures as well as the limits on both a per risk and per event basis. These plans are approved and monitored by the Board and Group Underwriting Committee of Canopus Managing Agents Limited, and the Boards of CRe and Canopus US Insurance, Inc., as applicable.

In the underwriting of insurance and reinsurance business the Group's underwriters use a variety of techniques, including applying their skill, knowledge and, where relevant, data on past claims experience to estimate the likely claims cost and therefore premium which should be sufficient (across a portfolio of risks and over a period of years) to cover claims, expenses and produce an acceptable return on capital. However, due to the nature of insurance risk there is no guarantee that the premiums charged will be sufficient to cover the cost of claims.

The Group seeks to limit exposures and the quantum and likelihood of loss that it is prepared to accept using stochastic and other modelling techniques by reference to a range of events such as natural catastrophes and specific scenarios which may result in large industry losses. These are monitored through catastrophe modelling over a range of return periods and the regular calculation of realistic disaster scenarios. The aggregate of exposures is monitored at the time of underwriting a risk, and reports are regularly produced to highlight the aggregations.

The Group has in place personal authority limits which are binding upon all staff authorised to underwrite and are specific to underwriters and classes of business. These authority limits are enforced through a sign-off process for underwriting transactions. Exception reports are also run regularly to monitor compliance.

A proportion of the Group's insurance is written by third parties under delegated authorities. The Group has in place a delegated authority policy and control framework. The policy covers all aspects of delegated underwriting and control of coverholders including initial due diligence, frequency and monitoring of bordereaux and requirements for both internal reviews and external audits. Compliance with the policy is regularly monitored.

#### *Catastrophe modelling*

The greatest likelihood of significant losses to the Group arises from natural catastrophe events, such as windstorm, earthquake or flood. The Group licences leading industry modelling tools, and supplements these with the Group's knowledge of the business, historical loss information and geographic accumulations, to monitor aggregation and to simulate catastrophe losses. The range of scenarios considered includes natural catastrophe, property, marine, liability and terrorism events.

The Group's capital setting methodology enables modelling to be performed in a sophisticated, but practical, manner particularly with respect to defining the strength of correlations between the Group's catastrophe exposed classes of business. The Group's stochastic models use underlying event tables which capture directly the different geographic distributions of risk in the different lines of business.

Effective risk management in non-core areas and from non modelled perils is ensured using a suite of exposure accumulation and aggregation monitoring techniques and proprietary deterministic models.

## Notes to the consolidated financial statements

Year ended 31 December 2018

### 32. Management of insurance and financial risk (continued)

#### *Catastrophe modelling (continued)*

A detailed analysis of catastrophe exposure by class of business is carried out monthly and a review against the Group's catastrophe risk tolerance is carried out on a quarterly basis and reported to the Board.

#### *Reinsurance*

Reinsurance risk to the Group arises when reinsurance contracts put in place to reduce gross insurance risk do not perform as anticipated. Failure of a reinsurer to pay a valid claim is considered a credit risk.

The Group's reinsurance programmes are determined from the underwriting teams' business plans and seek to protect capital from adverse severity and/or frequency of claims on both per risk and per event basis. Reinsurance is purchased to protect both current and discontinued lines of business.

The Group sets limits for reinsurance programmes regarding quality and quantity. Utilisation of the reinsurance protection is monitored on an on-going basis.

There are a number of areas of uncertainty over the reinsurance assumptions. The allocation of IBNR to the reinsurance programme is an uncertain exercise as there is limited knowledge of the size or number of future claims advices. The assumption over future reinsurance recoveries may be incorrect and unforeseen disputes could arise which reduce the recoveries made. The impact on profit before tax of a 1% deterioration in the total reinsurance recoveries would be a \$1.7 million loss (2017: \$2.7 million loss).

#### *Claims management*

Claims management risk may arise in the event of inaccurate or incomplete case reserves and claims settlements, poor service quality or claims leakage. The Group's claims teams seek to ensure that claims handling activities are performed with a consistent approach and that a standardised resolution and adjustment process is adopted wherever possible.

#### *Reserving*

Reserve risk occurs when claims provisions make insufficient allowance for claims, claims handling expenses and reinsurance bad debt provisions.

The Group's actuarial teams use a range of recognised actuarial techniques to project gross premiums written, monitor claims development patterns and to determine the claims provisions. The Group reviews at least quarterly, premium and claims experience by class of business and year of account and the earned and projected ultimate gross and net loss ratios.

The claims provisions established can be more or less than adequate to meet eventual claims arising. The level of uncertainty varies from class to class but can arise from inadequate case reserves for known large losses and catastrophes or from inadequate provision for IBNR. The impact on profit before tax of a 1% improvement/deterioration in the total net claims reserves would be a \$16.0 million gain/loss (2017: \$16.1 million)

#### *Claims development tables*

The development of insurance liabilities provides a measure of the Group's ability to estimate the ultimate value of claims. At 31 December 2018, of the Group's gross claims reserves of \$2,147m, \$1,994 million (93%) were attributable to Syndicate 4444, \$70 million (3%) to Canopus US Insurance, Inc and \$83 million (4%) to Canopus Reinsurance AG.

The figures in the tables below are presented at the exchange rates prevailing at 31 December 2018.

## Notes to the consolidated financial statements

Year ended 31 December 2018

## 32. Management of insurance and financial risk (continued)

## Claims development tables (continued)

Underwriting year – Gross \$m	2009 and prior	2010	2011	2012	2013	2014	2015	2016	2017	2018	Total
Estimate of ultimate claims costs:											
At end of period 1	786	404	402	524	624	669	762	755	1,044	749	6,719
At end of year 2	768	559	422	671	610	630	714	856	1,147		6,377
At end of year 3	740	564	635	676	587	638	786	883			5,509
At end of year 4	725	890	638	660	577	650	777				4,917
At end of year 5	937	874	627	651	595	642					4,326
At end of year 6	920	863	622	659	579						3,643
At end of year 7	911	862	627	649							3,049
At end of year 8	914	884	618								2,416
At end of year 9	862	864									1,726
At end of year 10	847										847
Older years	69										69
Current estimate of cumulative gross claims	916	864	618	649	579	642	777	883	1,147	749	7,824
Cumulative payments to date	(787)	(825)	(567)	(556)	(491)	(484)	(498)	(523)	(510)	(74)	(5,315)
Gross claims outstanding	129	39	51	93	88	158	279	360	637	675	2,509
Unearned balance											(399)
Unallocated loss adjustment expenses											37
Total liability											2,147

**Notes to the consolidated financial statements**  
Year ended 31 December 2018

**32. Management of insurance and financial risk (continued)**

**Claims development tables (continued)**

Underwriting year – Net \$m	2009 and prior	2010	2011	2012	2013	2014	2015	2016	2017	2018	Total
Estimate of ultimate claims costs:											
At end of period 1	448	345	352	444	543	580	650	631	795	613	5,401
At end of year 2	459	426	370	561	555	552	631	698	885		5,137
At end of year 3	442	421	502	568	539	551	671	731			4,425
At end of year 4	428	627	505	546	530	556	656				3,848
At end of year 5	589	612	485	538	548	553					3,335
At end of year 6	579	603	490	543	532						2,747
At end of year 7	573	603	494	532							2,202
At end of year 8	575	619	485								1,679
At end of year 9	595	603									1,198
At end of year 10	581										581
Older years	39										39
Current estimate of cumulative net claims	620	603	485	532	532	553	656	731	885	613	6,210
Cumulative payments to date	(546)	(567)	(439)	(454)	(458)	(423)	(458)	(470)	(432)	(72)	(4,319)
Net claims outstanding	74	36	46	78	74	130	198	261	453	541	1,891
Unearned balance											(326)
Unallocated loss adjustment expenses											37
Total liability											1,602

## Notes to the consolidated financial statements

Year ended 31 December 2018

### 32. Management of insurance and financial risk (continued)

#### Operational risk

Failure to manage operational risk can result in direct or indirect financial loss, reputational damage, regulatory censure or failure in the management of other risks.

The Group's operational risk process flows directly from the risk management process and sets out the principles and practices used to manage operational risk. Operational risk is managed through the Group's infrastructure, controls, systems and people supported by Compliance, Risk and Internal Audit functions.

#### Financial risk

The Group is exposed to a wide range of financial risks, the key financial risk being that the proceeds from its assets are not sufficient to fund the obligations arising from its insurance contracts. The Group carries financial investments at fair value through income and actively monitors its investment portfolio and its valuation.

An asset-liability management framework sets out our approach to managing potential exposure to financial risk which could arise where the specific interdependencies between assets and liabilities are not recognised or mitigated, and where there is a correlation between the risks within different asset classes.

The Group's policies and procedures for managing its exposure to financial risk, being (a) market risk, including valuation, market price, interest rate, credit spreads and exchange rate risks; (b) credit risk; and (c) liquidity risk, are given below:

#### (a) Market risk

Market risk arises from fluctuations in values, including from movements in market prices, interest rates, credit spreads and exchange rates.

##### i) Valuation

As explained in Note 20, the Group classifies its financial instruments using the fair value hierarchy required by IFRS 13 'Fair value measurement'.

##### ii) Market price

The Group invests in a diversified portfolio consisting mainly of core short duration fixed income securities, money market instruments and return seeking assets whose aim is to broadly match the duration of underlying liabilities. The return seeking assets include absolute return, hedge fund exposures as well as emerging market debt, Collateralised Loan Obligations (CLOs), commodities and London listed investment companies.

The cash and core fixed income portfolio as at end of December 2018 represented 66% of the Group's financial assets, while the diversifying and return seeking allocation was 34%.

**Notes to the consolidated financial statements**

Year ended 31 December 2018

**32. Management of insurance and financial risk (continued)****Financial risk – market risk (continued)****iii) Interest rate sensitivity of the fixed income portfolio**

The majority of the Group's investments are held in cash, cash equivalents and fixed income securities (bonds). Although these bond holdings help to meet claims and liabilities as they fall due, their market value is related to the level of interest and the average length of time until the cash flows from these securities are due to be paid back to the investor (duration).

If interest rates change, as a result of macro-economic developments and changes in monetary policy, the market price of these fixed income securities will also change. The aggregate duration of the fixed income portfolio can provide an estimate of the extent to which the market value of these securities will change for a given change (1% or 100 basis point) in bond yields.

By way of example, the value of fixed income investments in the Group's balance sheet at 31 December 2018 was \$1,124 million (2017: \$1,184 million) with an average duration of 2.8 years (2017: 2.2 years). If interest rates were to rise or fall by 100 basis points at the balance sheet date, the market value of the fixed income securities would be expected to decrease or increase by \$26.3 million (2017: \$25.3million).

The Group manages interest rate risk by broadly matching the duration of its cash and fixed income portfolio to that of the liabilities and by ensuring that aggregate average duration is less than 3 years.

The Investment Committee monitors the duration of the assets on a regular basis and will often make a decision to lower the duration or interest rate sensitivity of the bond portfolio if it believes that we are entering a period where interest rates are likely to rise in order to limit the impact on the market value of the portfolio.

The Group did not hold debenture loans at 31 December 2018 or 31 December 2017.

**iv) Credit spreads**

Fixed interest securities issued by an entity other than a sovereign government generally trade at higher yields than a similar duration sovereign government bond issued in the same currency. The excess yield (over a government bond of similar duration and currency) is referred to as the credit spread. While this spread may be influenced by the level of liquidity and demand for the corporate, it is typically taken to reflect the credit risk to the investor that the issuer may not make timely payments of capital or interest.

As with interest rate duration, there is a similar measure of credit duration that will show the relative performance of a corporate security for a given (1% or 100 basis point) change in the credit spread relative the equivalent government bond.

If credit spreads were to rise or fall by 100 basis points at the balance sheet date, the fair value of the non-government fixed income securities and therefore the profit after tax and equity would decrease or increase by \$11.3 million (2017: \$11.3 million).

The Investment Committee monitors the credit spread duration of the assets on a regular basis. It also sets and monitors limits on the amount and categories of non-government credit that our external investment managers can hold in the portfolio.

**Notes to the consolidated financial statements**

Year ended 31 December 2018

**32. Management of insurance and financial risk (continued)****v) Exchange rates**

The Group operates internationally and has exposure to foreign exchange risk. The Group seeks to hold its net assets primarily in US dollars. Where the risk of loss through mismatch of other currencies is deemed material, the Group will seek to mitigate the risk by buying or selling the relevant currency assets or entering into forward currency sale or purchase contracts.

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates (the "functional currency"). The Group's consolidated financial statements are presented in US Dollars (the "presentation currency"). Accordingly, the Group actively manages its non US dollar balance sheet exposures, which are predominantly against the Euro, Canadian Dollar and Sterling.

The net currency position at 31 December 2018 and 31 December 2017 was:

**Statement of profit or loss 'at risk' exposures:**

At 31 December 2018	GBP £'000	EUR €'000	CAD C\$'000
Gross exposure	140,413	79,099	(28,814)
Hedging	<u>(164,532)</u>	<u>(45,643)</u>	<u>24,407</u>
Net exposure	<u>(24,119)</u>	<u>33,456</u>	<u>(4,407)</u>
At 31 December 2017	GBP £'000	EUR €'000	CAD C\$'000
Gross exposure	93,643	48,262	(27,526)
Hedging	<u>(75,925)</u>	<u>(43,940)</u>	<u>29,894</u>
Net exposure	<u>17,718</u>	<u>4,322</u>	<u>2,368</u>

It is estimated that the effect of a 10% strengthening (or weakening) of exchange rates against US dollar would decrease/(increase) profit after tax and equity by approximately \$1.9 million (2017: \$1.3m) for Sterling and decrease/(increase) profit after tax by approximately \$2.9 million (2017: \$0.4m) for Euro.



**Notes to the consolidated financial statements**

Year ended 31 December 2018

**32. Management of insurance and financial risk (continued)****(b) Credit risk**

Credit risk arises where another party fails to perform its financial obligations or fails to perform them in a timely fashion. The primary sources of credit risk for the Group are:

- Amounts due from reinsurers;
- Amounts due from insurance contract holders;
- Amounts due from insurance intermediaries; and
- Counterparty risk with respect to investments including cash and cash equivalents.

Credit risk within the investment funds is principally managed through the credit research carried out by external investment managers. The investment guidelines are designed to mitigate credit risk by ensuring diversification of the holdings. Fixed income investments are predominantly invested in government and high grade corporate bonds.

The credit risk in respect of reinsurance debtors is primarily managed by review and approval of reinsurance security, prior to the purchase of reinsurance contracts. Guidelines are set and monitored that limit the purchase of reinsurance based on Standard & Poor's or appropriate alternative ratings for each reinsurer.

An analysis of the Group's major exposures to counterparty credit risk, which is based on Standard & Poor's or equivalent rating, is presented below:

<b>At 31 December 2018</b>	<b>AAA</b>	<b>AA</b>	<b>A</b>	<b>Other and/or not rated</b>	<b>Total</b>
<b>\$'000</b>					
Reinsurance assets	-	218,597	322,729	70,307	611,633
Reinsurance receivables	-	-	-	94,377	94,377
Debt and fixed income securities	641,560	107,777	279,470	94,940	1,123,747
Holdings in collective investment schemes	78,624	53,571	59,110	611,073	802,378
Cash and cash equivalents	-	-	165,563	-	165,563
<b>Total</b>	<b>720,184</b>	<b>379,945</b>	<b>826,872</b>	<b>870,697</b>	<b>2,797,698</b>

<b>At 31 December 2017</b>	<b>AAA</b>	<b>AA</b>	<b>A</b>	<b>Other and/or not rated</b>	<b>Total</b>
<b>\$'000</b>					
Reinsurance assets	-	196,261	336,553	78,170	610,984
Reinsurance receivables	-	-	-	127,320	127,320
Debt and fixed income securities	622,976	101,156	306,182	150,401	1,180,715
Holdings in collective investment schemes	114,793	6,248	9,226	537,762	668,029
Cash and cash equivalents	-	-	-	245,384	245,384
<b>Total</b>	<b>737,769</b>	<b>303,665</b>	<b>651,961</b>	<b>1,139,037</b>	<b>2,832,432</b>

## Notes to the consolidated financial statements

Year ended 31 December 2018

## 32. Management of insurance and financial risk (continued)

## (b) Credit risk (continued)

The underlying investments in the 'other/not rated' holdings in collective investment schemes (that includes participation in investment pools) at 31 December 2018 comprised:

\$'000	2018	2017
Absolute return funds	297,658	141,198
Bond funds	77,362	72,966
Commodities	11,396	21,511
Equities	7,857	46,054
Funds of hedge funds	5,285	7,569
Hedge funds	74,471	67,896
Money market funds	35,368	-
BBB and below securities	46,945	78,740
Non rated	54,731	101,828
Total	<u>611,073</u>	<u>537,762</u>

The carrying values represent the maximum exposure to credit risk at the balance sheet date in respect of the above assets. Insurance and reinsurance debtors are included in loans and receivables. The analysis above does not include insurance receivables from direct insurance operations as the majority of these assets are in respect of pipeline premiums for which the credit information is not readily available. The following table, which includes loans and receivables, including insurance receivables (debtors arising out of direct insurance operations), provides information regarding the carrying value of financial assets that have been impaired and the ageing of financial assets that are past due but not impaired.

At 31 December 2018	Neither past due nor impaired	Past due but not impaired (during range of months)				Impaired	Carrying Value \$'000
		0-3	3-6	6-12	Over 12		
Reinsurance assets	556,586	24,465	12,234	9,174	9,174	-	611,633
Insurance receivables	618,199	-	-	-	313	-	618,512
Financial assets at fair value	1,989,790	-	-	-	-	-	1,989,790

At 31 December 2017	Neither past due nor impaired	Past due but not impaired (during range of months)				Impaired	Carrying Value \$'000
		0-3	3-6	6-12	Over 12		
Reinsurance assets	531,556	58,472	10,478	-	10,478	-	610,984
Insurance receivables	636,684	-	-	-	-	-	636,684
Financial assets at fair value	1,889,310	-	-	-	-	-	1,889,310

**Notes to the consolidated financial statements**

Year ended 31 December 2018

**32. Management of insurance and financial risk (continued)****(c) Liquidity risk**

Liquidity risk arises where insufficient financial resources are maintained to meet liabilities as they fall due. The Group is exposed to daily calls on its available cash resources, principally from claims arising from its insurance activities and the payment of expenses.

The Group's policy is to manage its liquidity position so that it can reasonably meet a significant individual or market loss event. This means that the Group maintains sufficient liquid assets, or assets that can be quickly converted into liquid assets, without any significant capital loss, to meet estimated cash flow requirements. These liquid funds are regularly monitored against cash flow forecasts.

The majority of the Group's investments are in highly liquid assets which could be converted into cash in a prompt fashion and at minimal expense. Cash and cash equivalents are generally bank deposits and money funds.

The Group manages the maturity profile of its investments having regard to the expected pay-out pattern for the claims liabilities.

The contractual maturity profile at 31 December 2018 was as follows:

\$'000	Loan	Debt and other fixed income securities	Holdings in collective investment schemes	Cash and cash equivalents	2018 Total	2017 Total
Less than one year	2,700	87,770	-	165,563	256,033	758,073
Between one and two years	2,700	256,695	-	-	259,395	277,868
Between two and five years	8,100	537,053	-	-	545,153	772,001
Over five years	-	242,229	-	-	242,229	98,176
	13,500	1,123,747	-	165,563	1,302,810	1,906,118
Other non-dated instruments	-	-	802,378	-	802,378	201,510
	13,500	1,123,747	802,378	165,563	2,105,188	2,107,628

The expected payment profile of gross insurance contract liabilities as at 31 December 2018 was as follows:

	2018	2017
Less than one year	1,219,636	941,211
Between one and two years	840,194	1,048,778
Between two and five years	352,339	349,593
Over five years	298,133	349,592
	<u>2,710,302</u>	<u>2,689,174</u>

Claims outstanding is reported net of discounting credit on non-life annuities liability business of \$17.2m (2017 \$8.1m).

The expected average duration of fixed income investments by currency is shown below:

	2018	2017
	Years	Years
Sterling	1.9	2.1
US dollar	2.9	2.8
Euro	2.1	3.2

By taking into account the diversifying and return seeking assets within the portfolio (in addition to the fixed income investments), the average duration of the portfolio is around 1.6 years.

**Notes to the consolidated financial statements**

Year ended 31 December 2018

**33. Operating lease commitments**

The Group has annual lease commitments for land, buildings and equipment. The future aggregate minimum lease payments under non-cancellable operating leases are as follows:

\$'000	Group 2018		Group 2017	
	Land and buildings	Equipment	Land and buildings	Equipment
Not later than one year	4,905	1,359	4,513	47
Later than one year but not later than five years	4,485	686	13,025	89
Later than five years	492	-	518	-
	<u>9,882</u>	<u>2,045</u>	<u>18,056</u>	<u>136</u>

**34. Guarantees and contingencies****(a) Assets securing insurance and other liabilities**

Of the total of financial assets, cash and cash equivalents and other assets disclosed on the Group's balance sheet, \$1,197 million (2017: \$1,175 million) are held in Lloyd's Premium and other trust funds supporting insurance liabilities, or is collateralising letters of credit. These assets are subject to restrictions under the relevant trust deeds and bank facilities.

**(b) Deeds of Indemnity**

During 2018, the Group entered into three (2017: none) new Deeds of Indemnity with Lloyd's, bringing the total to twenty one (2017: eighteen). Five (2017: five) of the Deeds relate to reorganisations of the Group's corporate members, who participated on Syndicates 958, 4444 and 6115. The other sixteen (2017: thirteen) Deeds are to cover remote potential liabilities that may arise following the release by Lloyd's between 2006 and 2016 of various members' FAL.

**(c) Bank facilities**

As at 31 December 2018, the Group had the following facility available to it for letters of credit which may be deposited in FAL:

- \$250 million (2017: \$703 million) unsecured, of which \$238 million (2017: \$703 million) has been utilised to support underwriting on Syndicate 4444's 2017, 2018 and 2019 years of account.

In addition, Canopus Reinsurance AG (formerly Sompo Japan Canopus Reinsurance AG) ("CRe") had the following facility:

- Letters of credit totalling \$20.9 million (2017: \$6.1 million) with various overseas cedants. Should CRe fail to meet its obligations under contracts with these cedants they would be able to drawdown on these letters of credit. The letters of credit facilities are all secured by a charge over certain of CRe's bank deposits totalling \$21.0 million (2017: \$6.4 million).

**Notes to the consolidated financial statements**

Year ended 31 December 2018

**35. Related party transactions**

Details of the ultimate and immediate parent companies of CAG can be found in note 3.1.

**Key management compensation**

Key management personnel are those directors and senior managers responsible for the activities of the Group. During the year key management comprised of eighteen (2017: twelve) persons. Ten (2017: eight) of the key management persons were directors. Details of the remuneration of the Group's key management personnel, including the directors, are shown below in aggregate for each of the categories specified by IAS 24 – 'Related party disclosures'.

\$'000	2018	2017
Short-term employment benefits	7,393	4,772
Post-employment benefits	-	-

**Loans to related parties**

Non-interest bearing season ticket loans made to directors and members of key management during the year amounted to \$nil (2017: \$2.1k) of which \$nil (2017: \$nil) was outstanding as at 31 December 2018. Loans in relation to share purchases in Fortuna Topco Limited amounted to \$1.1m (2017: \$nil).

**Transactions with other related parties, including directors of the group companies**

There are no other related party transactions to report.

**36. Subsequent events**

On the 18th April 2019, Fortuna Holdings Limited ("FHL"), the immediate parent company of CAG, agreed a definitive sale and purchase agreement that will see the merger of its Lloyd's business with that of AmTrust at Lloyd's, a division of AmTrust Financial Services Inc ("AFSI"). Following completion, the Group will assume the management of AmTrust Syndicate 1861. As part of the transaction AFSI will become a significant minority shareholder in the Group.

On 2nd May 2019 FHL entered into a strategic partnership with Samsung Fire & Marine Insurance ("SFMI"). Under the terms of the transaction, SFMI will become a significant minority shareholder in the Group.

The above transactions are both subject to necessary regulatory approval and are expected to close in the third quarter of 2019.