Arch Europe Insurance Services Ltd

(Registered number 06645619)

Annual Report and Financial Statements
For the year ended 31 December 2012

Annual Report and Financial Statements for the year ended 31 December 2012

Contents

Directors' Report

The Directors present their annual report of Arch Europe Insurance Services Ltd ("the Company") and the audited financial statements for the year ended 31 December 2012

Ownership

The Company's ultimate parent company is Arch Capital Group Ltd ("ACGL"), a Bermuda-based company with $5 57 billion (2011 $5 0 billion) of capital at 31 December 2012 Through operations in Bermuda, the United States, Europe and Canada, ACGL provides insurance and reinsurance on a worldwide basis ACGL is listed on the NASDAQ U S stock exchange

The Company is directly owned by Arch Insurance Company (Europe) Limited ("AICE"), an FSA regulated insurance company that underwrites Property, Energy, Marine and Casualty insurance business with a focus on Specialty lines of insurance

Principal Activities and Business Review

The Company was formed to provide services in the form of staff and facilities to AICE and Arch Underwriting at Lloyd's Ltd ("AUAL") The Company incurs all significant staff and facility costs and pays all suppliers on behalf of AICE and AUAL and has a policy for re-charging these costs, including a margin, to the aforementioned companies as a secondment and service charge which is recognised as turnover

Results and Dividends

The Company's result for the year is a profit of £0 6m (2011 £0 6m) generated through a secondment and service charge received from AICE and AUAL During the year the Company paid an interim dividend in the amount of £4 million (no dividend was paid in 2011) to AICE, the Company's sole shareholder

The Company's key performance indicators for the year were as follows

	2012	**2011**
Turnover	£25 9m	£23 2m
Operating Profit	£0 9m	£0 9m
Net Profit	£0 6m	£0 6m

Future Outlook

The Company expects a similar level of turnover in 2012 As there are no expected changes to the service and secondment margin charged, the level of operating profit to turnover is expected to remain consistent with the current year

Principal Risks and Uncertainties

The Company's operations expose it to a variety of risks that include operational risk, credit risk, liquidity risk, interest rate cash flow risk and capital risk

The Board of Directors has ultimate responsibility for the Company's risk management This includes approval of the business plan, the maintenance of financial resources and for ensuring the adequacy of the systems and internal controls, including risk governance arrangements The Board gains assurance from a number of sources that include Internal Audit, Legal & Compliance and internal controls testing

Directors' report *(continued)*

Principal Risks and Uncertainties *(continued)*

The Company has a defined strategy and system of governance to define its risk policies and to manage these The Board of Directors holds ultimate responsibility for the risk management strategy, the business plan and the maintenance and management of financial resources The authority to meet these goals is delegated to the executive management of the Company in the form of the Management Committee The Board of Directors is responsible for ensuring the adequacy of the systems and controls including

- risk governance arrangements and an appropriate business plan,
- overseeing the development of appropriate systems for the management of potential risks,
- establishing adequate internal controls, and
- ensuring that the firm maintains adequate financial resources

Details of the risks are described in note 3 of these financial statements

Corporate and Social Responsibility

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

The global Arch group of companies maintains a Code of Business Conduct, which describes our ethical principles and includes policies designed to assist in preventing violations of the Code and to allow the Company to respond appropriately to any actual or potential violations To help set the standards of behaviour expected from all staff, the Company provides a training course on the Code intended to help guide employees in the way that they conduct business

The Company is committed to providing equal opportunities to potential and actual employees in all aspects of employment Our employment policies are non-discriminatory on any grounds relating to selection, training, career development or any other employment matters

Our success depends upon on having highly capable people who fit well with the Company's culture of performance, accountability, teamwork and ethical conduct Staff are encouraged to continue professional education and each employee is encouraged to develop a personal development plan with their managers

Charitable Donations

During the year the Company made charitable donations of £5,327 (2011 £10,489) in keeping with the company's corporate and social responsibilities No donations were made for political purposes (2011 nil)

Directors

The names of the Directors of the Company during the year and up to the date of signing the financial statements are listed on the Directors and Administration page of these financial statements

Directors' report *(continued)*

Statement of directors' responsibilities
The directors are responsible for preparing the Directors' Report and the financial statements in accordance with applicable law and regulations

Company law requires the directors to prepare financial statements for each financial year Under that law the directors have prepared the financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union In preparing these financial statements, the directors have also elected to comply with IFRSs, issued by the International Accounting Standards Board (IASB) Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period In preparing these financial statements, the directors are required to

- select suitable accounting policies and then apply them consistently,
- make judgements and accounting estimates that are reasonable and prudent,
- state whether applicable International Financial Reporting Standards (IFRSs) as adopted by the European Union [,and IFRSs as issued by the International Accounting Standards Board (IASB),] have been followed, subject to any material departures disclosed and explained in the financial statements,
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act 2006 They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities

The directors are responsible for the maintenance and integrity of the company's website Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions

Statement of Disclosure of Information to Independent Auditors

Each of the persons who is a Director at the date of this financial statement confirms that

- so far as the director is aware, there is no relevant audit information of which the company's auditors are unaware, and
- the director has taken all the steps that he ought to have taken as a director in order to make himself aware of any relevant audit information and to establish that the company's auditors are aware of that information

On behalf of the Board

Paul Robotham

P. Robotham
Director

26 March 2013

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF ARCH EUROPE INSURANCE SERVICES LTD

We have audited the financial statements of Arch Europe Insurance Services Ltd for the year ended 31 December 2012 which comprise the Statement of Financial Position, the Statement of Comprehensive Income, the Statement of Cash Flow, the Statement of Changes in Equity and the related notes The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union

Respective responsibilities of directors and auditors
As explained more fully in the Directors' Responsibilities Statement set out on page 3 the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland) Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors

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

Scope of the audit of the financial statements
An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error This includes an assessment of whether the accounting policies are appropriate to the company's circumstances and have been consistently applied and adequately disclosed, the reasonableness of significant accounting estimates made by the directors, and the overall presentation of the financial statements In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report

Opinion on financial statements
In our opinion the financial statements

- give a true and fair view of the state of the company's affairs as at 31 December 2012 and of its profit and cash flows for the year then ended,
- have been properly prepared in accordance with IFRSs as adopted by the European Union, and
- have been prepared in accordance with the requirements of the Companies Act 2006

Opinion on other matter prescribed by the Companies Act 2006
In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements

Matters on which we are required to report by exception
We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion

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

Mark Bolton

Mark Bolton (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London
27 March 2013

Statement of Comprehensive Income
For the year ended 31 December 2012

	Notes	2012 £000	2011 £000
Revenue	*4*	25,925	23,192
Administrative expenses		(25,032)	(22,301)
Operating profit		**893**	**891**
Finance expenses – bank charges		(161)	(57)
Profit before income tax		**732**	**834**
Income tax (expense) / benefit	*10*	(156)	(201)
Profit and total comprehensive income for the year attributable to owners		**576**	**633**

All amounts reflect continuing operations

The notes on page 9 to 19 form part of these financial statements

Statement of Financial Position
As at 31 December 2012

	Notes	2012 £000	2011 £000
Assets			
Non-current assets			
Property, plant and equipment	*13*	1,113	1,328
Intangible assets	*14*	1,197	1,074
Deferred tax	*11*	1,407	1,068
Non-current assets		**3,717**	**3,470**
Current assets			
Trade and other receivables	*12*	4,258	9,460
Cash and cash equivalents		4,808	2,646
Prepayments		707	615
Current tax asset		325	149
Current assets		**10,098**	**12,870**
Total Assets		**13,815**	**16,340**
Equity and liabilities			
Called up share capital	*16*	5,000	5,000
Retained earnings		3,862	5,717
Total equity (all attributable to owners of the Company)		**8,862**	**10,717**
Liabilities			
Non-current liabilities			
Trade and other payables – due after more than one year	*15*	620	225
Current liabilities			
Trade and other payables – due within one year	*15*	4,333	5,398
Total liabilities		**4,953**	**5,623**
Total equity and liabilities		**13,815**	**16,340**

The notes on page 9 to 19 form part of these financial statements

These financial statements and notes were approved by the Board of Directors on 26 March 2013 and were signed on its behalf by

J. Weatherstone
Director

27 March 2013

Statement of Changes in Equity
As at 31 December 2012

	Called up share capital	Retained earnings	Total
	£000	£000	£000
Balance at 1 January 2011	**5,000**	**3,889**	**8,889**
Profit and total comprehensive income for the year	-	633	633
Tax credit relating to share options	-	450	450
Share based payments	-	745	745
Balance at 31 December 2011	**5,000**	**5,717**	**10,717**
Profit and total comprehensive income for the year	-	576	576
Tax credit relating to share options	-	372	372
Ordinary dividend paid	-	(4,000)	(4,000)
Share based payments	-	1,197	1,197
Balance at 31 December 2012	**5,000**	**3,862**	**8,862**

Statement of Cash Flows
For the year ended 31 December 2012

	2012 £000	2011 £000
Profit before tax	732	834
Adjustments to reconcile profit before tax to net cash provided by operating income		
Income taxes paid	(156)	(201)
Other reserves	1,569	1,195
Changes in operational assets	5,257	(4,760)
Changes in operational liabilities	(670)	686
Net cash flows from operating activities	**6,732**	**(2,246)**
Purchase of property, plant and equipment	(92)	(578)
Purchase of intangible assets	(478)	(529)
Net cash flows from investing activities	**(570)**	**(1,107)**
Net cash flows from financing activities	**(4,000)**	**-**
Net increase / (reduction) in cash and cash equivalents	**2,162**	**(3,353)**
Cash and cash equivalents at 1 January	**2,646**	**5,999**
Net increase / (reduction) in cash and cash equivalents	2,162	(3,353)
Cash and cash equivalents at 31 December	**4,808**	**2,646**

Notes to the Financial Statements

1 General Information

Arch Europe Insurance Services Ltd is a UK incorporated company domiciled in England and Wales The address of the registered office is provided on the Directors and Administration page and the nature of the company's operating and principal activities are included within the Directors' Report

2 Accounting Policies

(a) Basis of preparation

These financial statements have been prepared in accordance with the International Financial Reporting Standards (IFRS) as adopted by the European Union (EU), IFRC Interpretations and the Companies Act 2006 applicable to companies reporting under IFRS

The financial statements have been prepared under the historical cost convention and are compiled on a going concern basis

The preparation of financial statements in conformity with IFRSs requires management to make judgements, estimates and assumptions that affect the application of accounting policies and reported amounts of assets, liabilities, income and expenses

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

The financial statements are prepared and presented in UK sterling and are rounded to the nearest thousand unless otherwise stated

(b) Management fees

Management fees are calculated on a cost incurred plus mark-up basis, which is defined in the service and secondment agreement, and are credited over the period in which they are considered to be earned.

(c) Functional currency

The functional currency of the Company has been determined to be UK sterling

(d) Foreign currencies

Transactions in foreign currencies are recorded using the rate of exchange ruling at the date of the transaction Monetary assets and liabilities denominated in foreign currencies are translated using the contracted rate or the rate of exchange ruling at the balance sheet date and the gains or losses on translation are included in the statement of comprehensive income

(e) Cash and cash equivalents

The Company has classified cash deposits and short-term highly liquid investments as cash and cash equivalents These assets are readily convertible into known amounts of cash

(f) Trade and other receivables

Trade receivables are amounts due for services performed in the ordinary course of business If collection is expected in one year or less, they are classified as current assets If not, they are presented as non-current assets

(g) Trade and other payables

Creditors are obligations to pay for goods or services that have been acquired in the ordinary course of business from suppliers These are classified as current liabilities if payment is due within one year or less If not, they are presented as non-current liabilities

Notes to the Financial Statements *(continued)*

2 Accounting Policies *(continued)*

(h) Deferred taxation

Deferred tax is recognised in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes Deferred tax is measured at the tax rates that are expected to be applied to the temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities and assets, and they relate to income taxes levied by the same tax authority on the same taxable entity

A deferred tax asset is recognised for unused tax losses, tax credits and deductible temporary differences, to the extent that is probable that future taxable profits will be available against which the asset can be utilised Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised

(i) Property, plant and equipment

(i) Recognition and measurement

Items of property, plant and equipment are measured at cost or deemed cost less accumulated depreciation and impairment losses Cost includes expenditures that are directly attributable to the acquisition of the asset

Gain and losses on disposal of an item of property, plant and equipment are determined by comparing the proceeds from disposal with the carrying amount of property, plant and equipment, and are recognised net within other income in profit or loss

(ii) Subsequent costs

The cost of replacing part of an item of property, plant and equipment is recognised in the carrying amount of the item if it is probable that the future economic benefits embodied within the part will flow to the Company and its cost can be measured reliably The costs of the day-to-day servicing are recognised in profit or loss as incurred

(iii) Depreciation

Depreciation is calculated over the depreciable amount, which is the cost of an asset, or other amount substituted for cost, less its residual value

Depreciation is recognised in profit or loss on a straight-line basis over the estimated useful lives of each part of an item, since this most closely reflects the expected pattern of consumption of the future economic benefits embodied in the asset Leased assets are depreciated over the shorter of the lease term and their useful lives

The estimate useful lives for the current and comparative periods are as follows

• Leasehold improvements	Over the term of the lease (currently 10 years)
• Computer software	6 years
• Furniture and Fixtures	5 years
• Other computer Hardware	3 years

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

(j) Intangible assets

Intangible assets comprise of computer software which is measured at cost or deemed cost less accumulated depreciation and impairment losses Amortisation is recognised in profit or loss on a straight line basis over the estimate useful life of the computer software, which is 6 years

Notes to the Financial Statements *(continued)*

2 Accounting Policies *(continued)*

(k) *Pension costs*

All employees are eligible to become members of a defined contribution Group Personal Pension Plan The assets of the scheme are held separately from those of the Company in an independently administered fund The amount charged to the profit and loss account represents the contributions payable to the scheme in respect of the accounting year

(l) *Leases*

Rentals payable under operating leases are charged to the profit and loss account in equal annual instalments over the period of the lease

(m) *Share based payments*

Share based payment awards are granted by ACGL and recharges to the Company are expensed The grant date fair value of the Long-Term Incentive and Share Award Plan is recognised as an employee expense, with a corresponding increase in equity, over the period that the employees unconditionally become entitled to the awards The amount recognised as an expense is adjusted to reflect the number of awards for which the related service and non-market vesting conditions are expected to be met, such that the amount ultimately recognised as an expense is based on the number of awards that do meet the related service and non-market performance conditions at the vesting date For share-based payment awards with non-vesting conditions, the grant date fair value of the share based payment is measured to reflect such conditions and there is no true-up for differences between expected and actual outcomes

In all schemes offered, the employees are granted or purchase the shares of ACGL and the Company has no obligation to settle the share-based payment Therefore all schemes are accounted for as equity-settled share based payment transactions

(n) *Share capital*

Ordinary shares are classified as equity Incremental costs directly attributable to the issue of ordinary shares and share options are recognised as a deduction from equity, net of any tax effects

(o) *Provisions*

Provisions are provided for where there is a present obligation as a result of a past event, that can be measured reliably and it is probable that an outflow of economic benefits will be required to settle that obligation

(p) *Dividend Distribution*

Dividend distribution to the Company's shareholders is recognised as a liability in the financial statements in the period in which the dividends are approved by the Company's shareholders

(q) *New standards and interpretations not yet adopted*

The following is a list of standards that are in issue but are not effective in 2012, but have been endorsed for use in the EU, together with the effective date of application

- IAS 1 Amendment Presentation of other items of comprehensive income (effective 1 January 2013)

In addition, the following is a list of standards that are in issue but are not effective in 2012, and have not yet been endorsed for use in the EU, together with the effective date of application to the group

- Improvements to IFRSs (effective 1 January 2013)

The implications of these standards and interpretations are under review

Notes to the Financial Statements *(continued)*

3 Management of Risks

As described in the Directors' Report, the Board of Directors has ultimate responsibility for the Company's risk management The following paragraphs describe the principal risks and uncertainties facing the Company and any mitigation taken to limit those risks

Operational Risk

Most operational risks are addressed through the Company's business disaster scenario planning, including remediation measures The Company has an outsourcing policy and separately monitors its outsourcing risks

The Company outsources many of its non-core services, including I T support, operating systems maintenance and legal services

Outsourcing risk is managed through service agreements which define service standards These may be supported by periodic audits and the Company takes steps to satisfy itself as to the outsource provider's continuity and competence to provide the service being outsourced Controls reports are obtained when applicable

The Company's largest outsource service provider is Insure Services Limited (Xchanging) and total billed services charges from this supplier during 2012 were £3 3 million (2011 £2 8 million)

Credit Risk

The Company's exposure to credit risk is limited to the risk that AICE or AUAL will be unable to pay amounts when due This risk is mitigated by internal financial and capital commitments to those companies from companies forming part of the ACGL group of companies

Liquidity Risk

Liquidity risk arises where cash may not be available to pay obligations when due Regular cash flow monitoring ensures that sufficient deposits are available to meet payments

Interest Rate Cash Flow Risk

The Company has interest bearing assets Interest bearing assets include cash balances on short term deposit which earn interest at a floating rate

Capital Risk

The Company maintains a capital level required to meet its obligations to continue on a going concern basis There is minimal pressure on the capital of the Company due to the nature of the operations of the Company

Notes to the Financial Statements *(continued)*

4 Revenue

	2012 £000	2011 £000
Management fees	25,925	23,192

Turnover is all derived within the United Kingdom

5 Operating Profit

	2012 £000	2011 £000
Operating profit is arrived at after charging		
Depreciation	306	290
Amortisation	355	309
Operating lease rentals		
- Land and buildings	794	845

6 Auditors' Remuneration

During the year, the Company obtained the following services from the parent company's auditor at costs detailed below

	2012 £000	2011 £000
Fees payable to the Company's auditors and their Associates for the audit of the Company's annual accounts	28	28
Fees payable to the Company's auditors and their associates for other services		
- Tax advisory services	20	-
- Other non-audit services	2	
	50	28

Notes to the Financial Statements *(continued)*

7 Directors and Employees Costs

(a) Directors' remuneration

All staff costs are recharged to either the parent company or fellow subsidiary companies There were no transactions between AEIS and its Directors and Officers during the year ended 31 December 2012 which require disclosure

	2012 £000	2011 £000
Directors' emoluments		
Aggregate emoluments	2,463	1,846
Amounts receivable under long-term incentive schemes	-	-
Company pension contributions to money purchase schemes	185	189
Compensation for loss of office	-	-
Highest paid director (included above)		
Aggregate of emoluments and awards under long-term incentive schemes, including nil pension contributions	485	298
Number of Directors who received shares in ACGL	9	9
Number of Directors participating in money purchase scheme	8	8
Number of Directors who exercised share options	1	1

The highest paid director received share allocations during the year under a long-term incentive scheme, with no shares being exercised during the year

(b) Staff Costs

The monthly average number of persons employed by the Company (including Executive Directors) during the year, analysed by category, was as follows

	2012 Number	2011 Number
Underwriting	51	46
Administration and Finance	45	39
Claims	12	11
	108	96

	2012 £000	2011 £000
The aggregate payroll costs of these persons were as follows		
Salaries	8,457	7,859
Social security costs	1,470	1,327
Other pension costs	862	764
Share based payments	1,202	745
	11,991	10,695

Notes to the Financial Statements *(continued)*

8 Pensions

The Company contributes to a defined contribution Group Personal Pension Plan The assets of the scheme are held separately from those of the Company in an independently administered fund The unpaid contributions outstanding at the end of the period were £73,833 (2011 £72,655)

9 Share Based Payments

The Company has a Share Award Plan intended to provide for competitive compensation opportunities, to encourage long-term service, to recognise individual contributions and reward achievement of performance goals The Plan is intended to promote the creation of long-term value for shareholders by aligning the interests of valued staff with those of shareholders The Plan provides for eligible employees and Directors to be granted stock options, stock appreciation rights, restricted shares, restricted share units payable in common shares or cash, share awards in lieu of cash awards, dividend equivalents and other share-based awards

In 2007, the Company introduced an Employee Share Purchase Plan (the "ESPP") The purpose of the ESPP is to give employees of ACGL and its subsidiaries an opportunity to purchase common shares through payroll deductions, thereby encouraging employees to share in the economic growth and success of ACGL and its subsidiaries The ESPP provides for consecutive six-month offering periods under which participating employees can elect to have up to 20% of their total compensation withheld and applied to the purchase of common shares of the Company at the end of the period The purchase price will be 85% of the fair market value of the common shares at the beginning of the offering period The maximum number of shares that may be purchased by an employee in any offering period is 3,000 shares In addition, a participant's right to purchase stock under the ESPP cannot accumulate at a rate in excess of USD $25,000 per calendar year

For purposes of determining estimated market value, the ultimate parent company has computed the estimated market values of share-based compensation related to stock options using the Black-Scholes option valuation model and has applied the assumptions set forth in the table below

	2012	**2011**
Dividend yield	0 0%	0 0%
Expected volatility	24 3%	24 6%
Risk free interest rate	1 0%	2 2%
Expected option life	6 25 Years	6 0 Years

The number and weighted average exercise prices of share awards are as follows

	Weighted average exercise price in $(USD)	**Number of options**	**Weighted average exercise price in $(USD)**	**Number of options**
	2012	**2012**	**2011**	**2011**
Outstanding at 1 January	20 82	310,601	18 40	317,277
Forfeited or expired during the period	19 29	(480)	-	-
Exercised during the period	20 57	(17,328)	13 43	46,669
Granted during the period	41 28	105,715	32 16	39,993
Outstanding at 31 December	26 26	398,508	20 92	310,601
Exercisable at 31 December	19 57	259,480	19 00	242,667

In May 2011, ACGL effected a three-for-one split of common shares The comparatives in the preceding table have been adjusted to reflect the share split

Notes to the Financial Statements *(continued)*

9 Share Based Payments *(continued)*

The share awards generally vest over a 3 year period with one third vesting on the first, second and third anniversaries of the grant date In addition, in November 2012 the Company issued off-cycle stock options and SARS to certain employees, which will cliff vest on the fifth anniversary of the grant date Option awards have a 10 year contractual life

The share awards outstanding at 31 December 2012 have an exercise price in the range of £13 00 to £ 43 52 (2011 £13 00 to £33 91) and a weighted average contractual life of 6 02 years (2011 8 38 years)

The weighted average share price at the date of exercise for share awards exercised in 2012 was £19 57 (2011 £30 18)

The charge to the statement of comprehensive income in respect of share based payments and the corresponding credit to equity was £1,197k (2011 £745k)

10 Income Tax Expense / (Benefit)

The Company is subject to tax laws enacted in the United Kingdom

The tax charged in the income statement comprises the following	2012 £000	2011 £000
Current tax expense / (benefit)		
Current period	200	246
Adjustments in respect of prior years	(78)	(46)
	122	200
Deferred tax (note 11)	34	1
	156	201

The standard rate of Corporation Tax in the UK changed from 26% to 24% with effect from 1 April 2012 Accordingly, the company's profits for this accounting year are taxed at an effective rate of 24 5%

The tax credited directly to equity comprises the following	2012 £000	2011 £000
Current tax credit on share option scheme	-	74
Deferred tax credit on share option scheme	397	376
Impact of tax rate change	(25)	-
	372	450

	2012 £000	2012 %	2011 £000	2011 %
Reconciliation of effective tax rate				
Profit before tax on continuing operations	732	-	834	-
Tax at the UK corporation tax rate of 24 5% (2011 26 5%)	179	24 5	221	26 5
Tax effect of expenses that are not deductible in determining taxable profit	91	12 4	91	10 9
Group Relief not paid for	(198)	(27 0)	-	-
Impact of rate change	84	11 5	(111)	(13 3)
Tax benefit and effective tax rate for the year	156	21 4	201	24 1

Notes to the Financial Statements *(continued)*

11 Deferred Tax Assets and Liabilities

Recognised deferred tax assets and liabilities

Deferred tax assets and liabilities are attributable to the following

	Assets		Liabilities		Net	
	2012	2011	2012	2011	2012	2011
	£000	£000	£000	£000	£000	£000
Property and equipment	-	-	(4)	(28)	(4)	(28)
Share-based payment transactions	1,274	947	-	-	1,274	947
Other items	137	71	-	78	137	149
Net tax assets / (liabilities)	1,411	1,018	(4)	50	1,407	1,068

12 Trade and Other Receivables

	2012	2011
	£000	£000
Due within one year		
Amounts owed from related parties	3,672	8,568
Other	586	892
	4,258	9,460

13 Property, Plant and Equipment

	Leasehold improvements	Fixtures, fittings & hardware	Computer Hardware	Total
	£000	£000	£000	£000
Book cost				
At 1 January 2012	1,441	370	319	2,130
Additions	65	3	23	91
Disposals	-	-	-	-
At 31 December 2012	1,506	373	342	2,221
Accumulated depreciation				
At 1 January 2012	387	227	188	802
Charge for the year	172	49	85	306
Disposals	-	-	-	-
At 31 December 2012	559	276	273	1,108
Net book value				
31 December 2012	947	97	69	1,113
31 December 2011	1,054	143	131	1,328

The assets are capitalised and depreciated over their estimated useful life based on original cost

Notes to the Financial Statements *(continued)*

14 Intangible Assets

	Computer software under service contract £000	Total £000
Book cost		
At 1 January 2012	2,059	2,059
Additions	478	478
Disposals	-	-
At 31 December 2012	2,537	2,537
Amortisation		
At 1 January 2012	985	985
Charge for the year	355	355
Disposals	-	-
At 31 December 2012	1,340	1,340
Net book value		
31 December 2012	1,197	1,197
31 December 2011	1,074	1,074

The assets are capitalised and amortised over their estimated useful life based on original cost

15 Trade and Other Payables

	2012 £000	2011 £000
Due within one year		
Other creditors	455	441
Amounts owed to related parties	629	1,258
Accrued expenses and deferred income	3 248	3,699
	4,333	5,398
Due after more than one year		
Accrued expenses and deferred income	620	225

16 Called Up Share Capital

	2012 £000	2011 £000
Authorised		
10,000,000 Ordinary shares of £1 each	10,000	10,000
Issued and fully paid		
5,000,000 Ordinary shares of £1 each	5,000	5,000

Notes to the Financial Statements *(continued)*

17 Operating Lease Arrangements

At the balance sheet date, the Company had outstanding commitments for future minimum lease payments under non-cancellable operating leases, which fall due as follows

	2012 £000	2011 £000
Within one year	916	916
In the second to fifth years inclusive	2,595	3,511
	3,511	4,427

18 Dividends

The following table shows the dividends paid to equity shareholders

	2012		2011	
	Pence (per ordinary share)	Dividend paid £000	Pence (per ordinary share)	Dividend paid £000
Interim dividend for the year ended 31st December 2012	80	4,000	-	-
	80	4,000	-	-

19 Ultimate Parent Company

The immediate parent of Arch Europe Insurance Services Ltd ("the Company") is Arch Insurance Company (Europe) Ltd ("AICE"), a Company incorporated in the United Kingdom The ultimate parent company is Arch Capital Group Ltd ("ACGL"), a company incorporated in Bermuda

The smallest and largest group in which the results of the Company are consolidated is that headed by ACGL The consolidated financial statements of ACGL is available to the public and may be obtained from Arch Capital Group Ltd, Wessex House, 45 Reid Street, Hamilton HM12, Bermuda

20 Related Party Transactions

The Company was formed to provide services in the form of staff and facilities to AICE and Arch Underwriting at Lloyd's Ltd ("AUAL") The Company incurs staff and facility costs and recharges them to AICE and AUAL The Company also has related party transactions with Arch Insurance Group Inc, a US service company, Arch Investment Management Ltd, a Bermuda based company providing investment management services, Arch International Services, a US service company, and Arch Risk Partners, a UK based mortgage insurance broker

The amounts sourced from related parties are detailed below

	2012		2011	
	Income and (expenses) incurred £000	(Payable) / Receivable £000	Income and (expenses) incurred £000	(Payable) / Receivable £000
Arch Insurance Company (Europe) Limited	13,302	2,555	13,473	7,647
Arch Underwriting at Lloyd's Ltd	12,623	(629)	9,779	(1,258)
Arch Insurance Group Inc	104	-	122	-
Arch Capital Services	(733)	32	(680)	-
Arch International Services	-	-	(65)	-
Arch Syndicate Investments Ltd	-	1,082	-	916
Arch Risk Partners	25	3	13	4

Directors and Administration

Directors

W Beveridge	Resigned 8th January 2013
E Fullerton-Rome	
D Hipkin	
P Robotham	
B Singh	
A Watson	
J Weatherstone	

Company Secretary

Knud Christensen	Resigned 31st August 2012
TMF Corporate Secretarial Services Limited	Appointed 1st September 2012

Registered Number

06645619

Registered Office

6th Floor
Plantation Place South
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London
EC3R 5AZ

Independent Auditors

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

Principal Bankers

Barclays Bank Plc, London

Website

www archinsurance co uk