

Arch Europe Insurance Services Ltd

(Registered number 06645619)

Annual Report and Financial Statements
For the year ended 31 December 2013



Annual Report and Financial Statements for the year ended 31 December 2013

Contents	Page
Strategic Report as at 31 December 2013	1-2
Directors' Report as at 31 December 2013	3-4
Independent Auditors' Report to the Members of Arch Europe Insurance Services Ltd	5-6
Statement of Comprehensive Income For the Year Ended 31 December 2013	7
Statement of Financial Position as at 31 December 2013	8
Statement of Changes in Equity as at 31 December 2013	9
Statement of Cash Flows for the Year Ended 31 December 2013	10
Notes to the Financial Statements	11-21
Directors and Administration	22

Strategic Report as at 31 December 2013

The directors present their strategic report of Arch Europe Insurance Services Ltd ("the Company") for the year ended 31 December 2013

Principal Activities and Business Review

The Company was formed to provide services in the form of staff and facilities to Arch Insurance Company (Europe) Ltd ("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 £0.5m (2012: £0.6m) generated through a secondment and service charge received from AICE and AUAL.

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

	2013	2012
Turnover	£29.2m	£25.9m
Operating Profit	£1.4m	£0.9m
Profit and total comprehensive income for the year	£0.5m	£0.6m

The Company's profit and total comprehensive income for the year is in line with 2012 despite a £0.5m increase in operating profit in 2013. This is largely due to an increased income tax charge in the current year (2013: £0.9m, 2012: £0.2m) (See note 10).

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.

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.

Strategic Report as at 31 December 2013 (continued)

Management of Risks

As described in the Strategic 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 IT 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 2013 were £2.1 million (2012: £3.3 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.

Future Outlook

The Company expects a similar level of turnover in 2014. 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.



J. Weatherstone
Director
26 March 2014

Directors' Report as at 31 December 2013

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 2013

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. The nature of the company's principal activities, outlook for the future and details of the company's financial risk management strategy are included within the Strategic Report (pages 1-2)

Ownership

The Company's ultimate parent company is Arch Capital Group Ltd ("ACGL"), a Bermuda-based company with \$6.5 billion (2012: \$5.6 billion) of capital at 31 December 2013. 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 US stock exchange.

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

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 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.

Directors

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

W Beveridge	Resigned 8 January 2013
E Fullerton-Rome	
D Hipkin	
P Robotham	Resigned 31 March 2013
B Singh	
A Watson	
J Weatherstone	

Directors' report as at 31 December 2013 (*continued*)

Statement of directors' responsibilities

The directors are responsible for preparing the Strategic Report, 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. 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 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



J. Weatherstone
Director
26 March 2014

Independent auditors' report to the members of Arch Europe Insurance Services Ltd

Report on the financial statements

Our opinion

In our opinion the financial statements, defined below

- give a true and fair view of the state of the company's affairs as at 31 December 2013 and of its profit and cashflows for the year then ended,
- have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union and
- have been prepared in accordance with the requirements of the Companies Act 2006

This opinion is to be read in the context of what we say in the remainder of this report

What we have audited

The financial statements, which are prepared by Arch Europe Insurance Services Ltd, comprise

- the statement of financial position as at 31 December 2013,
- the statement of comprehensive income for the year then ended,
- the statement of cash flows for the year then ended,
- the statement of changes in equity for the year then ended, and
- the notes to the financial statements, which include a summary of significant accounting policies and other explanatory information

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

In applying the financial reporting framework, the directors have made a number of subjective judgements, for example in respect of significant accounting estimates. In making such estimates, they have made assumptions and considered future events

What an audit of financial statements involves

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) ("ISAs (UK & Ireland)") 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 and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report

Independent auditors' report to the members of Arch Europe Insurance Services Ltd *(continued)*

Opinion on other matters prescribed by the Companies Act 2006

In our opinion the information given in the Directors' Report and Strategic Report for the financial year for which the financial statements are prepared is consistent with the financial statements

Other matters on which we are required to report by exception

Adequacy of accounting records and information and explanations received

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

- we have not received all the information and explanations we require for our audit, or
- adequate accounting records have not been kept, 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

We have no exceptions to report arising from this responsibility

Directors' remuneration

Under the Companies Act 2006 we are required to report to you if, in our opinion, certain disclosures of directors' remuneration specified by law are not made. We have no exceptions to report arising from this responsibility

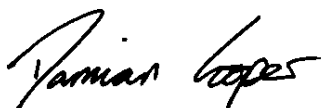
Responsibilities for the financial statements and the audit

Our responsibilities and those of the directors

As explained more fully in the Directors' Responsibilities Statement set out on page 4, 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 ISAs (UK & 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



Damian Cooper *(Senior Statutory Auditor)*
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
7 More London Riverside
London
SE1 2RT
26 March 2014

Statement of Comprehensive Income
For the year ended 31 December 2013

	Notes	2013 £000	2012 £000
Revenue	4	29,210	25,925
Administrative expenses		<u>(27,793)</u>	<u>(25,032)</u>
Operating profit		1,417	893
Finance expenses – bank charges		<u>(57)</u>	<u>(161)</u>
Profit before income tax		1,360	732
Income tax expense	10	<u>(906)</u>	<u>(156)</u>
Profit and total comprehensive income for the year attributable to owners		455	576

All amounts reflect continuing operations

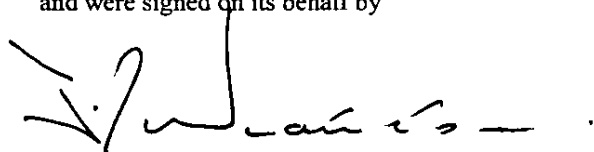
The notes on pages 11 to 21 form part of these financial statements

Statement of Financial Position
As at 31 December 2013

	Notes	2013 £000	2012 £000
Assets			
Non-current assets			
Property, plant and equipment	13	910	1,113
Intangible assets	14	1,430	1,197
Deferred tax	11	1,492	1,407
Non-current assets		3,832	3,717
Current assets			
Trade and other receivables	12	10,042	4,258
Cash and cash equivalents		1,610	4,808
Prepayments		594	707
Current tax asset	10	-	325
Current assets		12,246	10,098
Total Assets		16,078	13,815
Equity and liabilities			
Called up share capital	16	5,000	5,000
Retained earnings		6,482	3,862
Total equity (all attributable to owners of the Company)		11,482	8,862
Liabilities			
Non-current liabilities			
Trade and other payables – due after more than one year	15	744	620
Current liabilities			
Trade and other payables – due within one year	15	3,699	4,333
Current tax liability	10	153	-
Total liabilities		4,597	4,953
Total equity and liabilities		16,078	13,815

The notes on pages 11 to 21 form part of these financial statements

These financial statements and notes on pages 7 to 21 were approved by the Board of Directors on 26 March 2014 and were signed on its behalf by



J. Weatherstone
Director
26 March 2014

Statement of Changes in Equity
As at 31 December 2013

	Called up share capital	Retained earnings	Total
	£000	£000	£000
Balance at 1 January 2012	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
Profit and total comprehensive income for the year	-	455	455
Tax credit relating to share options	-	413	413
Ordinary dividend paid	-	-	-
Share based payments	-	1,752	1,752
Balance at 31 December 2013	5,000	6,482	11,482

Statement of Cash Flows

For the year ended 31 December 2013

	2013	2012
	£000	£000
Profit before tax	1,360	732
Adjustments to reconcile profit before tax to net cash provided by operating income		
Income taxes paid	(100)	(293)
Other reserves	2,165	1,569
Changes in operational assets	(4,702)	5,257
Changes in operational liabilities	(1,161)	(533)
Net cash flows generated from operating activities	(2,438)	6,732
Purchase of property, plant and equipment	(73)	(92)
Purchase of intangible assets	(687)	(478)
Net cash flows used in investing activities	(760)	(570)
Net cash flows used in financing activities	-	(4,000)
Net (reduction) / increase in cash and cash equivalents	(3,198)	2,162
Cash and cash equivalents at 1 January	4,808	2,646
Net (reduction) / increase in cash and cash equivalents	(3,198)	2,162
Cash and cash equivalents at 31 December	1,610	4,808

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

All accounting policies detailed below have been applied consistently.

(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), IFRIC 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 obliged 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 it 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 under service contract	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.

(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.

Notes to the Financial Statements (continued)

2 Accounting Policies (continued)

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 2013, but have been endorsed for use in the EU, together with the effective date of application:

- IAS 27 Amendment Separate financial statements (effective 1 January 2014)
- IAS 28 Amendment Investments in associates and joint ventures (effective 1 January 2014)
- IAS 32 Amendment Offsetting financial assets and financial liabilities (effective 1 January 2014)
- IFRS 10 Amendment Consolidated financial statements (effective 1 January 2014)
- IFRS 11 Amendment Joint arrangements (effective 1 January 2014)
- IFRS 12 Amendment Disclosures of interests in other entities (effective 1 January 2014)

In addition, the following is a list of standards that are in issue but are not effective in 2013, and have not yet been endorsed for use in the EU, together with the effective date of application to the group:

- IAS 36 Impairment of assets (effective 1 January 2014)
- IFRS 9 Financial Instruments (effective 1 January 2015)

The implications of these standards and interpretations are under review.

Notes to the Financial Statements (continued)

3 Revenue

	2013 £000	2012 £000
Management fees	29,210	25,925

Turnover is all derived within the United Kingdom

4 Operating Profit

	2013 £000	2012 £000
Operating profit is arrived at after charging		
Depreciation	275	306
Amortisation	454	355
Operating lease rentals		
- Land and buildings	845	794

5 Auditors' Remuneration

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

	2013 £000	2012 £000
Fees payable to the Company's auditors and their Associates for the audit of the Company's annual financial statements	41	28
Fees payable to the Company's auditors and their associates for other services		
- Tax advisory services	79	20
- Other non-audit services	24	2
	144	50

Notes to the Financial Statements (continued)

6 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 2013 which require disclosure.

	2013 £000	2012 £000
Directors' emoluments		
Aggregate emoluments	2,317	2,463
Amounts receivable under long-term incentive schemes	100	-
Company pension contributions to money purchase schemes	150	185
Compensation for loss of office	158	-
 Highest paid director (included above)		
Aggregate of emoluments and awards under long-term incentive schemes, including £38k in pension contributions (2012: £33k)	579	485
 Number of Directors who received shares in ACGL	4	9
Number of Directors participating in money purchase scheme	4	8
Number of Directors who exercised share options	3	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 (2012: nil).

(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:

	2013 Number	2012 Number
Underwriting	54	51
Administration and Finance	46	45
Claims	14	12
	<u>114</u>	<u>108</u>
	2013 £000	2012 £000
The aggregate payroll costs of these persons were as follows		
Wages and salaries	8,887	8,457
Social security costs	1,905	1,470
Other pension costs	1,000	862
Share based payments	1,456	1,202
	<u>13,248</u>	<u>11,991</u>

Notes to the Financial Statements (continued)

7 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 year were £118,976 (2012 £73,833).

8 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.

	2013	2012
Dividend yield	0.0%	0.0%
Expected volatility	23.6%	24.3%
Risk free interest rate	1.0%	1.0%
Expected option life	6.00 Years	6.25 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
	2013	2013	2012	2012
Outstanding at 1 January	26.26	398,508	20.82	310,601
Forfeited or expired during the period	39.50	(20,174)	19.29	(480)
Exercised during the period	18.20	(97,964)	20.57	(17,328)
Granted during the period	53.53	32,350	41.28	105,715
Outstanding at 31 December	30.76	312,720	26.26	398,508
Exercisable at 31 December	22.32	192,507	19.57	259,480

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 2013 have an exercise price in the range of \$13.00 to \$53.50 (2012 £13.00 to £43.52) and a weighted average contractual life of 3.84 years (2012 6.02 years).

The weighted average share price at the date of exercise for share awards exercised in 2013 was \$22.32 (2012 \$19.57).

The charge to the statement of comprehensive income in respect of share based payments and the corresponding credit to equity was £1,752k (2012 £1,197k).

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

	2013 £000	2012 £000
Current tax expense / (benefit)		
Current period	708	200
Adjustments in respect of prior years	400	(78)
	<u>1,108</u>	<u>122</u>

Deferred tax (note 11)

Current year movement	(215)	(129)
Adjustments in respect of prior years	(91)	79
Adjustments in respect of prior years in share options and restricted stock	(27)	-
Impact of tax rate change	131	84
	<u>906</u>	<u>156</u>

The standard rate of corporation tax in the UK changed from 24% to 23% with effect from 1 April 2013. Accordingly the company's profits for this accounting period are taxed at an effective rate of 23.3%. During the year, as a result of the changes in the UK corporation tax rate to 21% from 1 April 2014 and to 20% from 1 April 2015, which were substantially enacted on 2 July 2013, the relevant deferred tax balances have been re-measured.

The tax credited directly to equity comprises the following

	2013 £000	2012 £000
Current tax credit on share option scheme	(530)	-
Deferred tax credit on share option scheme	97	397
Prior year adjustment	(87)	-
Impact of tax rate change	107	(25)
	<u>(413)</u>	<u>372</u>

Notes to the Financial Statements (continued)

10 Income Tax Expense / (Benefit) (continued)

	2013 £000	2013 %	2012 £000	2012 %
Reconciliation of effective tax rate				
Profit before tax on continuing operations	1,360	-	732	-
Tax at the UK corporation tax rate of 23.3% (2012 24.5%)	316	23.3	179	24.5
Tax effect of expenses that are not deductible in determining taxable profit	178	13.0	91	12.4
Group relief received but not paid for	-	-	(198)	(27.0)
Impact of rate change	130	28.9	84	11.5
Prior year adjustment	282	1.5	-	-
Tax expense and effective tax rate for the year	906	66.7	156	21.4

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	
	2013 £000	2012 £000	2013 £000	2012 £000	2013 £000	2012 £000
Property and equipment	-	-	(4)	(4)	(4)	(4)
Restricted stock	351	168	-	-	351	168
Share options	805	1,106	-	-	805	1,106
Other items	340	137	-	-	340	137
Tax assets / (liabilities)	1,496	1,411	-	-	1,492	1,407
Net tax assets / (liabilities)	1,496	1,411	(4)	(4)	1,492	1,407

The deferred tax asset is likely to be realised beyond twelve months as the timing differences crystallise

12 Trade and Other Receivables

	2013 £000	2012 £000
Due within one year		
Amounts owed from related parties	9,481	3,672
Other	561	586
	10,042	4,258

Notes to the Financial Statements (continued)

13 Property, Plant and Equipment

	Leasehold improvements	Furniture and Fixtures	Other computer Hardware	Total
	£000	£000	£000	£000
Book cost				
At 1 January 2013	1,506	373	342	2,221
Additions	26	36	9	71
Disposals	-	-	-	-
At 31 December 2013	1,532	409	351	2,292
Accumulated depreciation				
At 1 January 2013	559	276	273	1,108
Charge for the year	174	42	58	274
Disposals	-	-	-	-
At 31 December 2013	733	318	331	1,382
Net book value				
31 December 2013	799	91	20	910
31 December 2012	947	97	69	1,113

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

14 Intangible Assets

	Computer software under service contract	Total
	£000	£000
Book cost		
At 1 January 2013	2,537	2,537
Additions	687	687
Disposals	-	-
At 31 December 2013	3,224	3,224
Amortisation		
At 1 January 2013	1,340	1,340
Charge for the year	454	454
Disposals	-	-
At 31 December 2013	1,794	1,794
Net book value		
31 December 2013	1,430	1,430
31 December 2012	1,197	1,197

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

Notes to the Financial Statements (continued)

15 Trade and Other Payables

	2013 £000	2012 £000
Due within one year		
Other creditors	30	455
Amounts owed to related parties	113	629
Accrued expenses and deferred income	3,556	3,248
	<u>3,699</u>	<u>4,333</u>
Due after more than one year		
Accrued expenses and deferred income	<u>744</u>	<u>620</u>

16 Called Up Share Capital

	2013 £000	2012 £000
<i>Authorised</i>		
10,000,000 (2012 10,000,000) Ordinary shares of £1 each	<u>10,000</u>	<u>10,000</u>
<i>Issued and fully paid</i>		
5,000,000 (2012 5,000,000) Ordinary shares of £1 each	<u>5,000</u>	<u>5,000</u>

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

	2013 £000	2012 £000
Within one year	1,011	916
In the second to fifth years inclusive	1,853	2,595
	<u>2,864</u>	<u>3,511</u>

18 Dividends

The following table shows the dividends paid to equity shareholders

	2013		2012	
	Pence (per ordinary share)	Pence (per ordinary share)	Pence (per ordinary share)	Dividend paid £000
Interim dividend for the year	-	-	80	4,000
	-	-	80	4,000

Notes to the Financial Statements (continued)

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

Key management personnel and director transactions

There were no transactions between the Company and its Directors and Officers during the year ended 31 December 2013 which require disclosure other than those detailed in note 6a.

Other 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 Capital Group Ltd, 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.

	2013		2012	
	Income and (expenses) incurred £000	(Payable) / Receivable £000	Income and (expenses) incurred £000	(Payable) / Receivable £000
Arch Insurance Company (Europe) Limited	10,206	2,093	13,302	2,555
Arch Underwriting at Lloyd's Ltd	19,004	6,092	12,623	(629)
Arch Insurance Group Inc	105	-	104	-
Arch Capital Services	(547)	-	(733)	32
Arch International Services	(16)	-	-	-
Arch Syndicate Investments Ltd	-	1,297	-	1,082
Arch Risk Partners	25	-	25	3
Arch Capital Group Ltd	-	(113)	-	-

Directors and Administration

Directors

W Beveridge	Resigned 8 January 2013
E Fullerton-Rome	
D Hipkin	
P Robotham	Resigned 31 March 2013
B Singh	
A Watson	
J Weatherstone	

Company Secretary

TMF Corporate Secretarial Services Limited

Registered Number

06645619

Registered Office

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

Principal Bankers

Barclays Bank Plc, London

Website

www.archinsurance.co.uk