

Arch Europe Insurance Services Ltd
(Registered number: 06645619)

**Annual Report and Financial Statements
for the year ended 31 December 2018**

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Annual Report and Financial Statements for the year ended 31 December 2018

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Strategic Report for the year ended 31 December 2018

The Directors present their strategic report of Arch Europe Insurance Services Ltd ("the Company") for the year ended 31 December 2018.

Principal Activities

The Company was formed to provide services in the form of staff and facilities to Arch Insurance (UK) Limited ("AIUK") (formerly Arch Insurance Company (Europe) Limited) and Arch Underwriting at Lloyd's Ltd ("AUAL"). The Company incurs all significant staff and facility costs and pays suppliers on behalf of AIUK 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.

Business Review

Results and Dividends

The Company's result for the year is a profit for the year of £0.2m (2017: £1.2m) generated through a secondment and service charge received from AIUK and AUAL.

During the year, the Company paid a dividend of £1.20 per ordinary share (2017: £0.80).

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

| | 2018 | 2017 |
|---------------------|--------|--------|
| Turnover | £40.8m | £38.9m |
| Operating Profit | £0.7m | £1.2m |
| Profit for the year | £0.2m | £1.2m |
| Net Assets | £6.9m | £11.1m |

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 for the year ended 31 December 2018 *(continued)*

Management of Risks

The Board of Directors has ultimate responsibility for the Company's risk management and licenced fellow group company, AIUK, to operate this business. 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. The Company's largest outsource service provider is Arch Global Services Inc.

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 seeks to limit exposure to operational risks through ensuring that an effective infrastructure, robust systems and controls, and appropriately experienced and qualified individuals are in place throughout the organisation.

The operational risk profile is reviewed by the Risk Committee and the controls to mitigate risks are included in Risk Register.

Credit Risk

The Company's exposure to credit risk is limited to the risk that AIUK 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 Arch Capital Group Ltd ("ACGL") group of companies. ACGL has an S&P credit rating A-.

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. Intercompany balances are also cleared regularly to facilitate this.

Interest Rate Cash Flow Risk

The Company has interest bearing assets. Interest bearing assets include cash balances on short-term deposit with third party banks, 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 and the support available from the ACGL group of companies.

Future Development

Following the acquisition of a book of business on 1st January 2019, by Arch UK Holdings Limited, the Company expects a higher level of turnover in 2019. 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.


Post balance sheet events

On 1st January 2019, Arch UK Holdings Limited acquired the UK Commercial Lines business owned by The Ardonagh Group and part of its Geo Underwriting operating segment. The acquisition will give AIUK a meaningful presence and an extended office network across the UK that will complement its existing London Market business.

Strategic Report for the year ended 31 December 2018 *(continued)*

As a result of this transaction, 236 employees were transferred to the Company. To facilitate the funding of this transaction, the Company received a capital contribution of £25.5m from AIUK and provided a loan of £32.5m to Arch UK Holdings Limited.

Approved by the Board and signed on behalf of the Board



Catherine Kelly
Director
18 September 2019

Directors' Report for the year ended 31 December 2018

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 2018.

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 of the financial statements.

The Company has no foreign branches.

During the year, the Company paid a dividend of £1.20 per ordinary share (2017: £0.80).

The auditors, PricewaterhouseCoopers LLP, have been reappointed for 2019.

Ownership

The Company's ultimate parent company is Arch Capital Group Ltd ("ACGL"), a Bermuda-based company with \$11.2 billion (2017: \$11.3 billion) of capital, comprised of shareholders' equity and debt, at 31 December 2018. 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 (UK) Limited ("AIUK"), a Prudential Regulation Authority ("PRA") regulated insurance company that underwrites Property, Energy, Marine, Personal Accident, Executive Assurance, Professional Liability and General Liability 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 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.

At the end of 2018, the Company had 156 staff. To ensure we maintain high performance standards across the organisation we conduct detailed annual appraisals focusing on identifying skills gaps and ensuring professional capabilities are maintained and advanced.

Directors

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

J. Kittinger
C. Kelly (appointed 1 May 2019)
M. Shulman (resigned 18 March 2019)
H. Sturgess (appointed 18 March 2019)

The Directors are covered by third party indemnity insurance policies.

Directors' Report for the year ended 31 December 2018 (continued)

Financial Risk Management

The Company is exposed to a wide variety of risks in the normal course of business. The Company has comprehensive arrangements in place for the management of risks that seek to mitigate the adverse effects risk can have on the Company's performance and position. The principal risks and uncertainties and the mechanism by which these risk and uncertainties are managed are addressed in the strategic report.

Principal Activities

Please refer to the Strategic Report on page 1.

Business Review

Please refer to the Strategic Report on page 1.

Principal Risk and Uncertainties

Please refer to the Strategic Report on page 1.

Future Developments

Please refer to the Strategic Report on page 2.

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 applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice), including Financial Reporting Standard 102 'The Financial Reporting Standard applicable in the UK and Republic of Ireland' (FRS 102).

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 United Kingdom Accounting Standards, including FRS 102, 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.


Directors' Report for the year ended 31 December 2018 *(continued)*

Statement of disclosure of information to independent auditors

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

- so far as the Director is aware, there is no relevant audit information of which the Company's auditors are unaware; and
- he 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.

Approved by the Board and signed on behalf of the Board



Catherine Kelly
Director
18 September 2019

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

Report on the audit of the financial statements

Opinion

In our opinion, Arch Europe Insurance Services Ltd's financial statements:

- give a true and fair view of the state of the company's affairs as at 31 December 2018 and of its profit for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards, comprising FRS 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland", and applicable law); and
- have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements, included within the Annual Report and Financial Statements (the "Annual Report"), which comprise: the balance sheet as at 31 December 2018; the profit and loss account, the statement of changes in equity for the year then ended; and the notes to the financial statements, which include a description of the significant accounting policies.

Basis for opinion

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

Independence

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

Conclusions relating to going concern

ISAs (UK) require us to report to you when:

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

We have nothing to report in respect of the above matters.

However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the company's ability to continue as a going concern. For example, the terms on which the United Kingdom may withdraw from the European Union are not clear, and it is difficult to evaluate all of the potential implications on the company's trade, customers, suppliers and the wider economy.

Reporting on other information

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

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

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

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

Strategic Report and Directors' Report

In our opinion, based on the work undertaken in the course of the audit, the information given in the Strategic Report and Directors' Report for the year ended 31 December 2018 is consistent with the financial statements and has been prepared in accordance with applicable legal requirements.

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

Responsibilities for the financial statements and the audit

Responsibilities of the directors for the financial statements

As explained more fully in the Statement of Directors' responsibilities set out on page 5, the directors are responsible for the preparation of the financial statements in accordance with the applicable framework and for being satisfied that they give a true and fair view. The directors are also responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the company's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the company or to cease operations, or have no realistic alternative but to do so.

Auditors' responsibilities for the audit of the financial statements

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

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

Use of this report

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

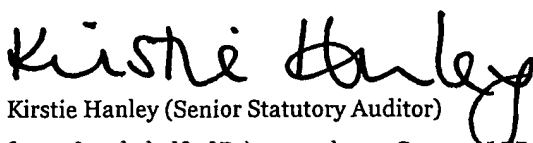
Other required reporting

Companies Act 2006 exception reporting

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

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

We have no exceptions to report arising from this responsibility.


Kirstie Hanley (Senior Statutory Auditor)

for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London 18 September 2019

Profit and Loss Account

For the year ended 31 December 2018

| | Notes | 2018 £000 | 2017 (Restated) £000 |
|---------------------------------------|-------|-----------------|----------------------------|
| Turnover | 4 | 40,769 | 38,944 |
| Administrative expenses | | <u>(40,052)</u> | <u>(37,776)</u> |
| Operating profit | 5 | 717 | 1,168 |
| Interest payable and similar expenses | | <u>(10)</u> | <u>(17)</u> |
| Profit before taxation | | 707 | 1,151 |
| Tax on profit | 10 | <u>(531)</u> | <u>57</u> |
| Profit for the financial year | | <u>176</u> | <u>1,208</u> |

All amounts reflect continuing operations.

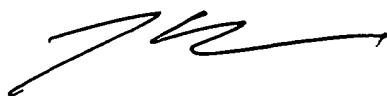
The notes on pages 12 to 23 form part of these financial statements.

Balance Sheet
As at 31 December 2018

| | Notes | 2018 £000 | 2017 (Restated) £000 |
|--|-------|---------------|----------------------------|
| Fixed assets | | | |
| Intangible assets | 14 | 1,375 | 1,568 |
| Tangible assets | 13 | 449 | 390 |
| | | 1,824 | 1,958 |
| Current assets | | | |
| Trade and other receivables | 12 | 3,297 | 14,827 |
| Prepayments and accrued income | | 948 | 724 |
| Cash at bank and in hand | | 7,994 | 804 |
| Deferred tax | 11 | 1,590 | 2,121 |
| Current assets: | | 13,829 | 18,476 |
| Creditors: amounts falling due within one year | 15 | 8,716 | 9,354 |
| Net current assets | | 5,113 | 9,122 |
| Total assets less current liabilities | | 6,937 | 11,080 |
| Net assets | | 6,937 | 11,080 |
| Equity | | | |
| Called up share capital | 16 | 5,000 | 5,000 |
| Retained earnings | | 1,937 | 6,080 |
| Total equity | | 6,937 | 11,080 |

The notes on pages 12 to 23 are an integral part of these financial statements.

The financial statements on pages 9 to 23 were authorised for issue by the Board of Directors on 18 September 2019 and were signed on its behalf by:



Jason Kittinger
SVP, Chief Financial Officer
18 September 2019

Statement of Changes in Equity
For the year ended 31 December 2018

| | Notes | Called up share capital £000 | Retained earnings £000 | Total £000 |
|---|-------|---|---------------------------------------|-----------------------|
| Balance at 1 January 2017 | | 5,000 | 7,182 | 12,182 |
| Profit for the financial year | | - | 1,208 | 732 |
| Share-based payments | 9 | - | 1,690 | 1,690 |
| Dividends | 18 | - | (4,000) | (4,000) |
| Balance at 31 December 2017 (Restated) | | 5,000 | 6,080 | 11,080 |
| Profit for the financial year | | - | 176 | 176 |
| Share-based payments | 9 | - | 1,681 | 1,681 |
| Dividends | 18 | - | (6,000) | (6,000) |
| Balance at 31 December 2018 | | 5,000 | 1,937 | 6,937 |

The notes on pages 12 to 23 form part of these financial statements.

Notes to the Financial Statements

1 General information

Arch Europe Insurance Services Ltd is a UK-incorporated private 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 Summary of significant accounting policies

All accounting policies detailed below have been applied consistently.

(a) Basis of preparation

The Company has adopted Financial Reporting Standard 102, 'The Financial Reporting Standard applicable in the UK and Republic of Ireland' (FRS 102). The financial statements of the Company have been prepared in accordance with FRS 102 and the Companies Act 2006 and prepared under the historical cost convention.

The preparation of financial statements in conformity with FRS 102 requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Company's accounting policies. Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected.

These are the Company's first financial statements prepared in accordance with FRS 102. The date of transition from FRS 101 to FRS 102 was 1 January 2017. This change has not resulted in any impact on either profit or equity during the year. Where the corresponding figures in the primary statements or notes to the accounts have been affected by this change, they have been marked as restated.

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

FRS 102 allows a qualifying entity certain disclosure exemptions, subject to certain conditions which have been complied with, including notification of, and no objection to, the use of exemptions by the Company's shareholders.

The following exemptions have been applied in the preparation of these financial statements, in accordance with FRS 102:

- The requirements of Section 7 '*Statement of Cash Flows*' and Section 3 '*Financial Statement Presentation*' paragraph 3.17(d), on the basis that the Company is a qualifying entity and the consolidated statement of cash flows included in the consolidated financial statements of its ultimate parent company includes the Company's cash flows.
- The requirements of Section 26 '*Share-based Payment*' paragraphs, 26.18(b), 26.19 to 26.21 and 26.23 (details of the number and weighted average exercise prices of share options, and how the fair value of goods or services received was determined), on the basis that it is a qualifying entity that is:
 - (i) a subsidiary, the share-based payment arrangement concerns equity instruments of another group entity;
 - (ii) an ultimate parent, the share-based payment arrangement concerns its own equity instruments and its separate financial statements are presented alongside the consolidated financial statements of the group;

and, in both cases, on the basis that the equivalent disclosures required by this FRS are included in the consolidated financial statements of the group in which the entity is consolidated.

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

Notes to the Financial Statements *(continued)*

2 Summary of significant accounting policies *(continued)*

(b) Going concern

The Company meets its day-to-day working capital requirements through its cash reserves. The nature of the Company's principal activities dictate that the Company should be able to operate within the level of its expected cash reserves. The Directors have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future. The Company therefore continues to adopt the going concern basis in preparing its financial statements.

(c) Secondment and service charge

Secondment and service charge 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.

(d) Functional and presentation currency

Items included in the financial statements of the Company are measured using the currency of the primary economic environment in which the Company operates ('the functional currency'). The financial statements are presented in pounds sterling (£), which is also the Company's functional currency.

(e) 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 profit and loss account.

(f) 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 and recognised on balance sheet date.

(g) 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 disclosed in the notes to the financial statements. If not, they are presented as non-current assets.

Trade and other receivables are recognised initially at cost on the trade date at which the Company becomes a party to the contract.

(h) Creditors

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

Creditors are recognised initially at cost on the trade date at which the Company becomes a party to the contract.

Notes to the Financial Statements (continued)

2 Summary of significant accounting policies (continued)

(i) Taxation

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

Current or deferred tax assets and liabilities are not discounted.

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

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

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

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

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

(j) Tangible Assets

(i) Recognition and measurement

Items of property, plant and equipment are stated at historical cost less depreciation. Historical cost includes expenditure that is directly attributable to the acquisition of the items. Residual values are reviewed at each year end.

Gains and losses on disposals of items of property, plant and equipment are determined by comparing the proceeds with the carrying amount of the disposed items, and are recognised net within 'other operating losses/gains' in the profit and loss account.

(ii) Subsequent costs

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Company and the cost of the item can be measured reliably. The carrying amount of the replaced part is derecognised. All other repairs and maintenance are charged to the profit and loss account during the financial period in which they are incurred.

Notes to the Financial Statements (continued)

2 Summary of significant accounting policies (continued)

(j) *Tangible Assets (continued)*

(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 within the profit and loss account 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 estimated useful lives for the current and comparative periods are as follows:

- | | |
|---------------------------|---|
| • Leasehold improvements | Over the term of the lease (currently 10 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 the conditions of the assets have changed.

(k) *Intangible assets*

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

(l) *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.

(m) *Leases*

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

(n) *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.

(o) *Share capital*

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

Notes to the Financial Statements (continued)

2 Summary of significant accounting policies (continued)

(p) 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. Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognised as interest expense.

(q) 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.

3 Critical accounting estimates and judgments

The Company makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimate and assumption that has a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are addressed below.

Useful economic lives of property, plant and equipment

The annual depreciation charge for property, plant and equipment is sensitive to changes in the estimated useful economic lives and residual values of the assets. The useful economic lives and residual values are re-assessed annually. They are amended when necessary to reflect current estimates, based on technological advancement, future investments, economic utilisation and the physical condition of the assets. See Note 13 for the carrying amount of the property plant and equipment, and note 2(j) for the useful economic lives of this asset.

Useful lives of Intangible assets

Where factors, such as technological advancement or changes in market price, indicate that residual value or useful life have changed, the residual value, useful life or amortisation rate are amended prospectively to reflect the new circumstances. The assets are reviewed for impairment if the above factors indicate that the carrying amount may be impaired. See Note 14 for the carrying amount of the intangible assets, and note 2(k) for the useful life of this asset.

4 Turnover

| | 2018 £000 | 2017 £000 |
|--|--------------|--------------|
| Secondment and service charge (All UK) | 40,769 | 38,944 |

5 Operating Profit

| | 2018 £000 | 2017 £000 |
|--|--------------|--------------|
| Operating profit is arrived at after charging: | | |
| Depreciation | 133 | 86 |
| Amortisation | 582 | 588 |
| Operating lease rentals: | | |
| - Land and buildings | 993 | 1,034 |

Notes to the Financial Statements (continued)

6 Auditors' Remuneration

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

| | 2018 £000 | 2017 £000 |
|--|--------------|--------------|
| Fees payable to the Company's auditors and their associates for the audit of the Company's annual financial statements | 38 | 37 |
| | <u>38</u> | <u>37</u> |

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 the Company and its Directors and Officers during the year ended 31 December 2018 which require disclosure.

| | 2018 £000 | 2017 £000 |
|--|--------------|--------------|
| Directors' emoluments | | |
| Aggregate emoluments | 1,940 | 2,683 |
| Amounts receivable under long-term incentive schemes | - | - |
| Company pension contributions to money purchase schemes | 17 | 47 |
| Compensation for loss of office | - | - |
| Highest paid Director (included above) | | |
| Aggregate of emoluments and awards under long-term incentive schemes, including £nil (2017: £nil) in pension contributions | 1,588 | 1,341 |
| Number of Directors who received shares in ACGL | 2 | 5 |
| Number of Directors participating in money purchase scheme | 1 | 2 |
| Number of Directors who exercised share options | 5 | 5 |

The highest paid Director received share allocations during the year under a long-term incentive scheme and exercised options during the year.

Notes to the Financial Statements (continued)

7 Directors' and Employees' Costs (continued)

(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:

| | 2018 Number | 2017 Number |
|---|----------------|----------------|
| Underwriting | 66 | 63 |
| Administration and Finance | 63 | 59 |
| Claims | 21 | 21 |
| | <u>150</u> | <u>143</u> |
| | 2018 £000 | 2017 £000 |
| The aggregate payroll costs of these persons were as follows: | | |
| - Wages and salaries | 13,037 | 12,507 |
| - Social security costs | 2,179 | 3,215 |
| - Other pension costs | 1,535 | 1,460 |
| - Share-based payments | 1,681 | 1,690 |
| | <u>18,432</u> | <u>18,872</u> |

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 year were nil (2017: nil).

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. These are awarded by ACGL not the Company.

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 stock appreciation rights 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 2018 have an exercise price in the range of \$6.43 to \$32.09 (2017: \$19.29 to \$96.26) and a weighted average contractual life of 6.09 years (2017: 5.91 years).

The weighted average share price at the date of exercise for share awards exercised in 2018 was \$28.29 (2017: \$93.87).

The Company also has 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.

Notes to the Financial Statements (continued)

9 Share-Based Payments (continued)

The charge to the Profit and Loss account in respect of share-based payment transactions and the corresponding credit to equity was £1.681m (2017: £1.690m).

10 Income Tax

| Tax expense / (income) included in profit or loss: | 2018 | 2017 (Restated) |
|--|------|--------------------|
| | £000 | £000 |
| Current tax: | | |
| - UK corporation tax on income for the year | - | - |
| - Adjustments in respect of prior years | - | (31) |
| Total current tax income | - | (31) |
| Deferred tax (Note 11): | | |
| - Origination and reversal of timing differences | 576 | (91) |
| - Adjustments in respect of prior years | 15 | 54 |
| - Impact of change in UK tax rate | (60) | 11 |
| Total deferred tax expense / (income) | 531 | (26) |
| Tax expense reported in Profit and Loss Account | 531 | (57) |

Reconciliation of tax charge

The tax expense for the year is higher (2017: lower) than the standard rate of corporation tax in the United Kingdom for the year ended 31 December 2018 of 19.00% (2017: 19.25%).

| The differences are explained below: | 2018 | 2017 |
|--|------|-------|
| | £000 | £000 |
| Profit on ordinary activities before taxation | 707 | 1,151 |
| Profit before taxation multiplied by the standard rate of tax in the UK of 19.00% (2017: 19.25%) | 134 | 221 |
| Effects of: | | |
| - Expenses not deductible for tax purposes | 55 | 61 |
| - Impact of change in UK tax rate | (60) | 11 |
| - Adjustments in respect of prior years | 15 | 23 |
| - Permanent differences on share options and restricted stock | 387 | (373) |
| Total tax expense / (income) for the year | 531 | (57) |

The effective tax rate for the current year is lower than the prior year due to changes in the rates of UK corporation tax, the main rate of which decreased from 20% to 19% with effect from 1 April 2017.

Changes to UK corporation tax rates were enacted on 15 September 2016 as part of Finance Act 2016. These changes included a further reduction to the main rate of tax, which will reduce from 19% to 17% with effect from 1 April 2020. Deferred taxes at the balance sheet date have been measured using these enacted tax rates and reflected in these financial statements.

Notes to the Financial Statements (continued)

11 Deferred Tax

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

| | 2018 £000 | 2017 £000 |
|--------------------------------|--------------|--------------|
| Trading losses | 621 | 934 |
| Decelerated capital allowances | 361 | 175 |
| Share-based payments | 608 | 1,012 |
| Deferred tax assets | 1,590 | 2,121 |
| Deferred tax liabilities | - | - |
| Net deferred tax assets | 1,590 | 2,121 |

The deferred tax assets are likely to be realised after more than one year as the timing differences reverse.

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

| | Unrelieved trading losses £000 | Decelerated capital allowances £000 | Share-based payments £000 | Total £000 |
|---|---|--|---------------------------------|---------------|
| At 1 January 2018 | 934 | 175 | 1,012 | 2,121 |
| Credited / (charged) to the profit and loss account | (313) | 186 | (404) | (531) |
| At 31 December 2018 | 621 | 361 | 608 | 1,590 |

The amount of the net reversal of deferred tax assets expected to occur next year is £500k, relating to the partial utilisation of carried-forward trading losses and the reversal of some of the existing timing differences on tangible fixed assets.

Notes to the Financial Statements (continued)

12 Trade and Other Receivables

| | 2018 £000 | 2017 £000 |
|------------------------------------|--------------|---------------|
| Due within one year: | | |
| Amounts owed by group undertakings | 2,955 | 13,418 |
| Other Debtors | 342 | 1,409 |
| | <u>3,297</u> | <u>14,827</u> |

13 Tangible Assets

| | Leasehold Improvements | Furniture and Fixtures | Other computer Hardware | Total |
|---------------------------|---------------------------|---------------------------|-------------------------------|--------------|
| | £000 | £000 | £000 | £000 |
| Book cost: | | | | |
| At 1 January 2018 | 445 | 368 | 722 | 1,535 |
| Additions | - | 31 | 161 | 192 |
| At 31 December 2018 | <u>445</u> | <u>399</u> | <u>883</u> | <u>1,727</u> |
| Accumulated depreciation: | | | | |
| At 1 January 2018 | 122 | 310 | 713 | 1,145 |
| Charge for the year | 44 | 27 | 62 | 133 |
| At 31 December 2018 | <u>166</u> | <u>337</u> | <u>775</u> | <u>1,278</u> |
| Net book value: | | | | |
| 31 December 2018 | 279 | 62 | 108 | 449 |
| 31 December 2017 | <u>323</u> | <u>58</u> | <u>9</u> | <u>390</u> |

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 2018 | 6,814 | 6,814 |
| Additions | 389 | 389 |
| At 31 December 2018 | <u>7,203</u> | <u>7,203</u> |
| Accumulated amortisation: | | |
| At 1 January 2018 | 5,246 | 5,246 |
| Charge for the year | 582 | 582 |
| At 31 December 2018 | <u>5,828</u> | <u>5,828</u> |
| Net book value: | | |
| 31 December 2018 | 1,375 | 1,375 |
| 31 December 2017 | <u>1,568</u> | <u>1,568</u> |

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

Notes to the Financial Statements (continued)

15 Creditors: amounts falling due within one year

| | 2018 £000 | 2017 £000 |
|--------------------------------------|--------------|--------------|
| Amounts falling due within one year: | | |
| Amounts owed to group undertakings | 2,671 | 3,186 |
| Other creditors | - | 53 |
| Current tax liabilities | - | - |
| Accruals and deferred income | 6,045 | 6,115 |
| | <u>8,716</u> | <u>9,354</u> |

16 Called Up Share Capital

| | 2018 £000 | 2017 £000 |
|--|--------------|--------------|
| <i>Authorised</i> | | |
| 5,000,000 (2017: 5,000,000) Ordinary shares of £1 each | 5,000 | 5,000 |
| <i>Issued and fully paid</i> | | |
| 5,000,000 (2017: 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:

| | 2018 £000 | 2017 £000 |
|---------------------------|--------------|--------------|
| Later than one year | 1,565 | 1,495 |
| Not later than five years | 5,878 | 5,580 |
| | <u>7,443</u> | <u>7,075</u> |

18 Dividends

The following table shows the dividends paid to equity shareholders:

| | 2018 | | 2017 | |
|-------------------------------|----------------------------------|--------------------------|----------------------------------|--------------------------|
| | Pence (per ordinary share) | Dividend Paid £000 | Pence (per ordinary share) | Dividend paid £000 |
| Interim dividend for the year | 120 | 6,000 | 80 | 4,000 |
| | <u>120</u> | <u>6,000</u> | <u>80</u> | <u>4,000</u> |

Notes to the Financial Statements (continued)

19 Ultimate Parent Company

The immediate parent of Arch Europe Insurance Services Ltd ("the Company") is Arch Insurance (UK) Limited ("AIUK"), a company incorporated in the United Kingdom. The ultimate parent undertaking and controlling party is Arch Capital Group Ltd ("ACGL"), a company incorporated in Bermuda.

Arch Capital Group Ltd is also the parent undertaking of the smallest and largest group of undertakings for which group financial statements are drawn up and of which the Company is a member. Copies of the consolidated financial statements of Arch Capital Group Ltd can be obtained from The Secretary, Arch Capital Group Ltd., Waterloo House, Ground Floor, 100 Pitts Bay Road, Pembroke HM08, 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 2018 which require disclosure other than those detailed in Note 7.

Other related party transactions

The Company was formed to provide services in the form of staff and facilities to AIUK and AUAL. The Company incurs staff and facility costs and recharges them to AIUK 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 Inc., a US service company, Arch Underwriters Europe Limited UK branch, the UK establishment of an Irish company that acts as an intermediary and provides support staff to other Arch group companies, and Arch Reinsurance Ltd.

The Company has taken advantage of the exemption from disclosing the Company's related party transactions in paragraph 33.1A of FRS 102.

Post Balance Sheet events

On 1st January 2019, Arch UK Holdings Limited acquired the UK Commercial Lines business owned by The Ardonagh Group and part of its Geo Underwriting operating segment. The acquisition will give AIUK a meaningful presence and an extended office network across the UK that will complement its existing London Market business. As a result of this transaction, 236 employees were transferred to the Company. To fund this transaction, the Company received a capital contribution of £25.5m from AIUK and provided a loan of £32.5m to Arch UK Holdings Limited.

Directors and Administration

Directors

J. Kittinger
C. Kelly (appointed 1 May 2019)
M. Shulman (resigned 18 March 2019)
H. Sturgess (appointed 18 March 2019)

Company Secretary

TMF Corporate Administration Services Limited

Registered Number

06645619

Registered Office

5th Floor
Plantation Place South
60 Great Tower Street
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