



## ANNUAL REPORT 2016

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## **CONTENTS**

Chairman's Statement	2
Chief Executive's Statement	3-4
The Board	5
Executive Management and Corporate Information	6
Directors' Report	7-11
Strategic Report	12-14
Independent Auditors' Report	15-16
Profit and Loss - Technical Account – General Business	17
Profit and Loss – Non-Technical Account	18
Balance Sheet	19
Statement of Changes in Equity	20
Statement of Cash Flows	21
Notes to the Financial Statements	22-43
Members' Profile	44

## CHAIRMAN'S STATEMENT

I am pleased to present the 2016 financial results for Pool Reinsurance Company Limited (Pool Re or the Company).

2016 saw an increase of £0.53bn in the value of the investment fund (financial investments, accrued income and investment cash) over the year to £6.26bn (2015: £5.73bn). As the fund represents the extent to which Pool Re can meet reinsurance claims without recourse to the UK taxpayer, its growth is an important indicator of our success in meeting one of the Company's founding objectives, namely, to operate at nil cost to the taxpayer over the life of the scheme.

In addition, in March 2016 we renewed our purchase of commercial reinsurance, increasing the cover to £1.9bn, and thereby further distancing the UK taxpayer from having any liability in the event of a claim.

We remain grateful to Her Majesty's Treasury (HMT) for its continuing support of the retrocession agreement. During 2016, as in every year of the Company's operation, Pool Re was a net contributor to government revenues, through retrocessional premium, corporation tax, income tax and national insurance payments.

As a result of the new Governmental Retrocession Agreement put in place in 2015, 2016 saw the first payment of dividends by Pool Re to its Members, with a matching payment of additional premium payable to HMT. Total premium payable to HMT in respect of 2016 was £249.7m.

2015 saw Pool Re organise and host the inaugural National Terrorism Reinsurance Pools Congress in London with attendees from 14 nations, providing an opportunity to share best practice on a global basis. In 2016 the Congress met in Canberra and in June 2017 the Congress will meet in Paris. This international collaboration is an example of the thought leadership initiatives being developed by Pool Re and is designed to share experience and best practice between terrorism (re)insurance entities.

I am also very pleased to note that the efforts of our team have not gone unnoticed and that Pool Re was again recognised with some of our industry's most prestigious awards including the prize for Risk Carrier of the Year at the Insurance Insider Honours and the award for Company of the Year at the Insurance Day London Market Awards.

On a formal note the Board has again revisited the Company's position in relation to Chapter 1 of the Competition Act 1998, and has concluded that, based on the facts known to it, including the new agreement with HMT, and the legal advice obtained, the Scheme continues to meet the exemption requirements set out in that Act.

I would like to thank our Board, the Company's staff and Executive Management for their individual and collective contributions to delivering another positive result and another momentous year in our Company's journey.

I look forward to meeting Members' representatives at the Company's AGM, in respect of which full details and joining instructions are included with this report. I hope that Members will take the opportunity of the AGM to meet the Company's Board and Executive Management.

**Geoff Riddell**  
Chairman  
16 March 2017

## CHIEF EXECUTIVE'S STATEMENT

During 2016, Pool Re has continued its evolution towards becoming a more resilient partner, both for its Members and for government. Whilst many initiatives came to fruition in 2016, the ground work began some years ago. Essential changes agreed as part of the negotiations with the government in 2014 have laid a foundation on which to expand the scope of the scheme, allowing Pool Re to become more than a passive fund that reacts when called upon, and to be much more proactive in its approach.

Work to modernise Pool Re began in 2013 by assessing how better to use the experience we have gained and the partnerships we have developed in the UK and internationally. Many of these efforts to modernise the scheme gained traction in 2016, as we also began to implement initiatives which expand our proposition.

Meanwhile we have continued to perform our core function well. Pool Re exists to serve its Members, Her Majesty's Government, and other stakeholders by ensuring that the UK is able to rebuild quickly in the aftermath of a terrorist event. Throughout its 23-year history, it has fulfilled this function each time it has been called upon. With this in mind, I am pleased to announce another strong financial performance.

Although gross premiums written for the year were little changed at £300.5m (2015: £306.9m), the profit for the financial year transferred to profit and loss account reserves of £298.3m, is very different from the 2015 result of £100.5m. The main driver of this increase is the very strong gross investment return of £364.1m, compared to the investment loss of £44.1m reported in 2015.

The investment strategy remained a prudent one, seeking a balance between risk and return. Interest rates remained low during 2016 and while markets began the year in a very volatile and negative mood, they recovered to end the year strongly. Risk assets including equity, commodities and multi-asset credit, generated strong performance. Returns were boosted further by the sharp fall in Sterling, following the referendum regarding Britain's membership of the EU. Investments in equity and commodities are held on an unhedged basis, but a strategy was put in place, prior to the referendum, whereby any unhedged non-Sterling exposure would be incrementally hedged should Sterling fall sharply.

2016 was the second year under the revised terms of the retrocession agreement between Pool Re and Her Majesty's Treasury (HMT), unanimously approved by Members at the EGM held on 21 November 2014. These terms took effect from 1 January 2015 and, in addition to an increase to 50% of the value of gross premiums being payable as outward reinsurance premiums to HMT, they include a provision for Pool Re to pay an annual distribution to Members, with a matching amount of further premium payable to HMT. The Board declared such a dividend on 28 June 2016 in respect of its 2015 results. The amount of the dividend paid was £33.5m.

I am pleased to report that the Company continued to build its investment fund during 2016 with the value of the fund (financial investments, accrued income and investment cash) growing by £0.53bn to a total value at 31 December 2016 of £6.26bn. Together with the renewed purchase of £1.9bn of external retrocession, the Government and UK taxpayer are further distanced from financial risk.

The threat posed by all forms of terrorism, be it Islamist Extremism, Dissident Republicanism or Far Left/Far Right Extremism remains persistent and unprecedented. The fact that our shores have been largely spared in recent years, is a testament to the extraordinary efforts of our security services. However, the threat level in the UK remains Severe and an attack, it would appear, is a matter of when, not if. Terrorism has evolved. We face a more advanced, diverse, and heightened threat than at any point in our recent history. The need for Pool Re to adapt to that set of circumstances, has therefore been thrust upon us.

To keep Pool Re at the forefront of terrorism reinsurance, we have ensured the tools, analytics, and spectrum of expertise at our disposal are sufficient to counter the evolving threat. In 2016, Ed Butler CBE DSO joined Pool Re as Head of Risk Analysis, and established our Terrorism Research and Analysis Centre. This team, and the research it produces, are an important asset for Pool Re, its Members, and wider stakeholders. It creates a resource through which we can inform the insurance industry of current and future terrorism threats and associated perils.

As a result, we have recognised that Pool Re's own capabilities and scope of coverage need to evolve with the terrorists' attack methods. With this in mind, we have formed a partnership with Cranfield University to develop the UK's first terrorism risk model to include the impact of a chemical, biological, radiological or nuclear (CBRN) attack. Improved understanding of changing exposures in the evolving threat environment is central to our modernisation. So too is the introduction of more risk-reflective pricing. The risk model will help in both areas.

To many people, the threat of cyber attack seems unquantifiable and (like UK terrorism in 1993) therefore uninsurable. Pool Re currently excludes acts of terrorism with a cyber trigger, but with tomorrow's terrorism risk increasingly focussed on cyber security, Pool Re, with the support of key scheme stakeholders including the Government and our regulators, is actively looking to find a way to cover the threat. We have commissioned research on the threat and nature of cyber terrorism from the Judge Business School at the University of Cambridge and this will inform our understanding of the issue and allow us to develop an appropriate extension of cover.

Driving closer collaboration between international terrorism reinsurance pools was a key achievement in 2015. Our work that year culminated in the inaugural Congress for National Terrorism (Re)insurance Pools. I am delighted that these relationships have deepened throughout 2016. The second Congress, held in Canberra, was a resounding success. It concluded with the launch of the International Forum of Terrorism Risk (Re)Insurance Pools (IFTRIP). Pool Re's initiative to foster closer ties and nurture greater collaboration between the world's terrorism (re)insurance entities has thus been met with the agreement and enthusiasm of our peers around the world. It is a defining moment for international collaboration between national terrorism pools, and may change the way that the insurance industry protects against, and responds to, acts of terrorism across the globe. I am truly proud we have been able to come together as an international community with a shared vision of the role which reinsurance pools can play in better protecting our nations' economies.

In June we announced an increase in the retentions of individual Members per event, which this year rose from £135 million to £150 million in total for any one event. Enabling the private market to retain increasing levels of terrorism losses is a fundamental objective. This is another important step towards that goal.

I am very pleased that those who report and comment on our industry have seen fit to recognise our efforts over the past year with a series of accolades including the prize for Risk Carrier of the Year at the Insurance Insider Honours, and the award for Company of the Year at the Insurance Day London Market Awards. I am honoured that our efforts have been recognised with these prestigious awards.

Throughout 2016, the Pool Re team continued to develop our relationship with Age UK in Lewisham. In line with our Corporate Social Responsibility policy, members of staff have volunteered for a variety of activities supporting the organisation.

In closing, I would like to thank the staff of Pool Re and the advisers with whom we have collaborated, for their tremendous efforts and counsel during 2016. We are a small team, but our accomplishments often belie this. We have maintained and strengthened the progress made last year, and implemented a number of new initiatives. The benefit will be felt by our Members and stakeholders in the UK and internationally. We live in deeply troubled and uncertain times. The outlook can often appear bleak. However, there is cause for optimism. As I hope this message shows, 2016 was a momentous year for Pool Re and I believe that, as a result, we are better prepared than ever to meet the challenges of our turbulent world.

**Julian Enoizi**  
Chief Executive  
16 March 2017

## THE BOARD

*Details of the current Directors of the Company are set out below.*

### **Geoffrey M Riddell #\***

*Chairman*

Aged 61. A Director since August 2015 and appointed Chairman from 1 February 2016. Former member of Zurich Insurance Group Executive Committee and Regional Chairman – Asia Pacific, Middle East and Africa based in Hong Kong.

### **Sir Brian G Bender**

Aged 68. A Director since May 2014, nominated by HM Treasury. Formerly a Permanent Secretary in the Civil Service. Chairman of the London Metal Exchange. Non-executive Director of the Financial Reporting Council and of Pool Reinsurance (Nuclear) Limited. Trustee of Lloyds Register Foundation. Governor of Dulwich College.

### **Peter J Box Chartered Accountant #\***

Aged 64. A Director since February 2010. Former audit and business advisory partner at PricewaterhouseCoopers. Director, Chairman of the Audit Committee and member of the Remuneration Committee of Marsh Limited. Director and Chairman of the Audit Committee and member of the Risk Committee of the Family Assurance Friendly Society Limited. Chairman of Trustees of the Royal Flying Doctor Service of Australia, Friends in the UK. Director, Chairman of the Risk and Audit Committee and member of the Remuneration Committee of Cardif Pinnacle Insurance Holdings plc.

### **Alan J Brown FSIP#\***

Aged 63. A Director since July 2008. Former Director and Group Chief Investment Officer of Schroders PLC. Chairman of the Carbon Disclosure Project and Chairman of Westway Trust. Governor of the Wellcome Trust.

### **Denise N Jagger Solicitor**

Aged 58. A Director since January 2014. A Partner of Eversheds LLP since 2004. Formerly Company Secretary and General Counsel of Asda Group plc and a Director of Asda Stores Limited. Non-executive director of Bellway plc. Chairman of St Giles Trust. Council Member of the University of York.

### **Stephen Lewis**

Aged 48. A Director since October 2012. From 1 January 2015, Chief Executive Officer for the UK and Western Europe of the RSA Group. Previously, between 1989 and 2014, Mr Lewis held a number of senior financial and operational roles with Zurich Insurance Group, becoming Chief Executive Officer of UK General Insurance and Shared Services of the UK Branch of Zurich Insurance plc. Member of the ABI Board.

### **Bronislaw (Bronek) E Masojada**

Aged 55. A Director since May 2015. Chief Executive of Hiscox since 2000. Prior to joining Hiscox Mr Masojada worked at McKinsey & Company, the management consulting firm. Between 2001 and 2007 he served as Deputy Chairman of Lloyd's, was appointed to the Court of The Worshipful Company of Insurers in 2009 and was Master in 2013/14. He also joined the ABI Board in 2012.

### **Andrew G Skirton #**

Aged 53. A Director since December 2011. Non-executive Chairman of Gartmore Group Limited between 2007 and 2011, and Co-Global Chief Executive Officer of Barclays Global Investors between 2002 and 2006.

### **Maurice E Tulloch**

Aged 48. A Director since April 2015. Chief Executive Officer of Aviva's UK & Ireland General Insurance business from October 2013 to January 2016, Chairman of Global General Insurance since July 2014, and a member of the Group Executive Committee since July 2012. Prior to appointment as Chief Executive Officer, Mr Tulloch held the role of Chief Executive Officer of Aviva Canada from November 2009. Member of the ABI Board, and Chair of the General Insurance Council.

*# Member of the Investment Committee*

*\* Member of the Remuneration Committee*

## **EXECUTIVE MANAGEMENT**

Chief Executive	Julian A P Enoizi
Chief Finance and Operations Officer	Peter N Aves FCA
General Counsel and Company Secretary	Christian Wells, Solicitor
Chief Underwriting Officer	Stephen M Coates ACII
Chief Investment Officer	Ian M Coulman MCSI
Head of Risk Analysis	Edward A Butler CBE

## **CORPORATE INFORMATION**

Registered in	England, United Kingdom
Registration number	2798901
Registered office	Hanover House, 14 Hanover Square, London W1S 1HP, United Kingdom
Principal office	5 Lloyd's Avenue, London, EC3N 3AE (until May 2017) Equitable House, 47 King William Street, London, EC4R 9AF (from May 2017)
Telephone number	+ 44 (0) 20 7337 7170
E-mail	enquiries@poolre.co.uk
Website	www.poolre.co.uk

## **DIRECTORS' REPORT**

The Directors of Pool Reinsurance Company Limited (registered number 2798901) present their report and the audited financial statements of the Company for the year ended 31 December 2016.

## **BOARD OF DIRECTORS**

### **Role of the Board**

The Board is responsible for providing entrepreneurial leadership of the Company within a framework of prudent and effective controls which enables risk to be assessed and managed. The Board sets the overall strategy of the Company and oversees its implementation, reviewing the performance of management, ensuring that there are appropriate systems of internal controls and risk management and ensuring that the necessary financial and human resources are in place for the Company to achieve its objectives and provide long-term value to Members. Talent management is an ongoing priority for the Board.

The Board's policy is to maintain a framework of corporate governance that would be considered good practice in companies of similar significance. Therefore, although the Company is neither required to comply with the UK Corporate Governance Code and certain other codes and guidelines generally applicable to listed companies, nor to make a statement on its compliance with such requirements, the Board believes it is appropriate to consider their provisions in determining the Company's own corporate governance arrangements, and also to describe such arrangements to the Members, which it does within this report.

The Board holds four regularly scheduled meetings each year, at which it considers reports from each of the key functions, in particular legal and regulatory, financial performance, investment management, market operations and threat analysis. In addition to these standing items, the Board considers other matters of significance to the Company annually, in accordance with an agreed schedule of matters to be considered in the forthcoming year. In addition to the regularly scheduled Board meetings, the Directors also meet at least once a year to review the Company's strategy, and ad hoc meetings are arranged as necessary.

There is a formal schedule of matters reserved to the Board, which is reviewed annually. Such matters include those which are considered to be of significant strategic importance, which affect the structure of the Pool Re Scheme, setting the culture, ethics, values and standards of the Company, or which affect the aforementioned corporate governance framework. The Board has otherwise delegated to its committees and to the executive management the power to make decisions on operational matters within a framework of internal controls. Each committee operates within written terms of reference and the respective roles and responsibilities of the Chairman and the Chief Executive are set out in writing, all of which may only be amended with the Board's approval. The appointment and removal of the Chief Executive and the General Counsel and Company Secretary are also matters reserved to the Board.

The Chairman, in conjunction with the Chief Executive and the General Counsel and Company Secretary, ensures that the Board receives the information it needs in order to discharge its responsibilities. All Directors have access to the services of the General Counsel and Company Secretary and independent professional advice is available to the Directors in respect of any issue arising in the course of their duties, at the expense of the Company. The Company maintains appropriate directors' and officers' liability insurance in respect of legal actions against its Directors.

Following their appointment, new Directors are given an in-depth induction by executive management and additional training is provided to Directors throughout their appointment to ensure that they possess the appropriate knowledge regarding the Company and its operations necessary for the effective performance of their role.

### **Composition**

The Board consists solely of non-executive Directors, including a non-executive Chairman. Brief biographical details of the current Directors are set out on page 5. Rather than appoint a senior independent director, the Board has determined that the role will be shared by two of the independent directors nominated by the Board from time to time. At this time the directors holding this position are Peter Box and Alan Brown.

The Directors who served during the year and up to the date of signing the financial statements were:

G M Riddell (Chairman from 1 February 2016)  
Sir Brian Bender



P J Box  
A J Brown  
D N Jagger  
A P Latham (Chairman until 1 February 2016, resigned 28 June 2016)  
S Lewis  
B E Masojada  
A G Skirton  
M E Tulloch

The appointment of all new Directors is a matter for consideration by the Board. The Articles of Association allow HM Government to nominate individuals to be considered by the Board for appointment as Directors, although only one Director at any time may hold office following nomination in this way. At present Sir Brian Bender is a Director following nomination by HM Government.

The composition of the Board is considered at appropriate intervals to ensure an appropriate balance of expertise and experience to support the strategic and operational direction of the Company. The importance of diversity is recognised and the Board members comprise members with a wide range of skills and experiences. Whilst the business pursues diversity, throughout the business, the Board is not committing to any specific targets. Instead the Board will continue to pursue a policy of appointing talented people at every level to deliver high performance. The need for a new Director and the profile of the required individual are agreed by the Board as a whole. Equal consideration is given to all suitable candidates irrespective of gender, race or any other demographic factor.

The Board considers annually the ongoing independence of each Director, taking into account the period they have served, whether they are also directors of companies within groups that cede business to Pool Re or whether they have been appointed by significant counterparties. The Board has determined that, as at the date of this statement, all of its Directors continue to be independent in character and judgement.

In accordance with the Articles of Association of the Company, all Directors must retire and seek election at the first Annual General Meeting following their appointment, and all Directors who have served continuously for more than nine years must retire and seek re-election at each Annual General Meeting. With the exception of the nominee of HM Government, a number nearest to one third of the other Directors must retire by rotation at each Annual General Meeting. Therefore, at the forthcoming Annual General Meeting:

- Mr Skirton, who will retire by rotation, will seek re-election;
- Mr Box, who will retire by rotation, will seek re-election and
- Mr Brown, who will retire by rotation, will seek re-election.

#### **Board Committees**

Until 31 December 2016 the Board had established four standing Committees to undertake certain of its responsibilities; being the Investment Committee, the Remuneration Committee, the Admissions Committee, and the Conflicts of Interest Committee, all of which operated within written terms of reference.

The role of the Investment Committee was (and remains) to consider the Company's investment matters and, where appropriate, it undertakes actions in accordance with the powers delegated to it, or makes recommendations to the Board. The Investment Committee was made up of the Chief Executive and those Directors who are noted to be members in the biographical details on page 5. The Investment Committee meets at least four times per year and throughout 2016 was chaired by the Chairman.

The role of the Remuneration Committee was to consider, and make recommendations to the Board in respect of, remuneration policy, remuneration budgets, the remuneration of the Chief Executive, and to make decisions relating to the remuneration of other members of executive management, including the structure of performance-related pay. The Remuneration Committee met at least twice a year and throughout 2016 was chaired by Mr Box, or in his absence, any other Director who was a member of this Committee other than the Chairman of the Board. The Remuneration Committee was made up of the Chairman of the Board and those Directors who are noted to be members in the biographical details on page 5.

The role of the Admissions Committee was to consider and approve the admission of prospective members to the Company and to authorise the execution of the relevant documents. The members of the Admissions Committee were the Chairman, the Chief Executive and the General Counsel and Company Secretary. The Admissions Committee met as and when required to consider applications for Membership.

The role of the Conflicts of Interest Committee was to consider and authorise situations where a Director's interests may conflict with the interests of the Company. The members of the Conflicts of Interest Committee were the Chairman and any one other Director (or where the matter to be considered related to the Chairman, another Director would serve in his place), who acted in consultation with the Chief Executive. The membership was flexible to ensure that members did not consider matters relating to themselves. The Conflicts of Interest Committee met as and when necessary.

With effect from 1 January 2017, the Committee structure was updated so that there are now three standing Committees, namely the Investment Committee, the Remuneration, Nominations and Conflicts Committee and the Audit Committee, all of which have written Terms of Reference. The Admissions Committee was disbanded with effect from 1 January 2017, with its former function now being undertaken by the Executive team.

In addition to the above committees, the Board may from time to time establish ad hoc committees to address any specific purpose, with such delegation of powers and membership as the Board considers appropriate or necessary to meet its aims.

In accordance with the Articles of Association, the proceedings of any Committee to which the Board has delegated powers are minuted and reported to the Directors at the next following Board meeting.

#### **Attendance at Meetings**

It is recognised that Directors' executive responsibilities outside of the Company may result in them being unable to attend all of the regularly scheduled Board meetings. On such occasions, the Chief Executive will obtain their comments on matters to be considered at the meeting in question for passing on to the other Directors as appropriate.

The table below sets out each Director's attendance at the meetings of the Board and the Investment and Remuneration Committees which they were eligible to attend during 2016.

	<u>Board</u>	<u>Investment Committee</u>	<u>Remuneration Committee</u>
G M Riddell	5 (5)	4 (4)	3 (3)
Sir Brian Bender	4 (5)		
P J Box	5 (5)	4 (4)	3 (3)
A J Brown	5 (5)	3 (4)	3 (3)
D N Jagger	5 (5)		
A P Latham	2 (2)	1 (2)	2 (2)
S Lewis	3 (5)		
B E Masojada	5 (5)		
A G Skirton	4 (5)	4 (4)	
M E Tulloch	4 (5)		

Possible number of meetings during the year that could be attended are shown in brackets.

#### **Performance Evaluation**

Each year the Board undertakes an evaluation of its performance, including assessing the performance of the Chairman, the Chief Executive and the Investment Committee. Currently, the evaluation process includes an assessment undertaken by external board performance consultants every three years, involving interviews with each of the Directors and members of executive management and culminating in a report to the Board as a whole, with intervening years being undertaken through self-assessment. The most recent self-assessment evaluation was undertaken at the beginning of 2016. The overall finding from this review was that the Board continued to operate very effectively with the appropriate balance of expertise, experience, independence and knowledge to deliver long-term value for the Members. Independent Audit Limited is currently undertaking an external evaluation of the Board and the governance of the Company.

## **Directors' Remuneration**

The Company's Articles of Association provide that until otherwise determined by ordinary resolution, there shall be paid to the Directors such fees as the Directors determine not exceeding an annual aggregate of £500,000. Members last approved an increase in the annual aggregate limit applicable to Directors' fees by amendment to the Articles of Association at the 2015 Annual General Meeting.

Subject to the annual aggregate limit, Directors receive fees at levels approved by the Board. These are reviewed by the Board on an annual basis, incorporating the use of market data to do so. Directors serving on the various Committees of the Board, other than Mr Riddell, also receive further fees to reflect the additional time commitment involved.

No Director receives any additional remuneration from the Company other than his or her fees. Directors are not paid compensation for loss of office.

## **Dividend**

The Articles of Association of the Company provide for distributions to Members in the form of a dividend and in the circumstances of a winding up.

## **Corporate Social Responsibility and Sustainability**

The Board recognises that the Company has a duty to ensure that day-to-day business practices are undertaken ethically, environmentally, sustainably and in a socially responsible manner. The business is operated through high ethical policies and practices. In the past year the Company has again chosen Age UK as its charity partner, and members of staff have supported the charity by volunteering as helpers at one of its day centres.

## **Financial Risk Management**

The Company's financial risk management objectives and policies with regard to the use of financial instruments are described in note 5 to the financial statements.

## **Directors' Indemnities**

The Company has entered into indemnities for the benefit of its existing Directors and future Directors, and these indemnities remained in force as at the date of this report. Copies of the Directors' indemnities, which are qualifying indemnity provisions, are available for inspection at the Company's registered office.

## **Statement of Directors' Responsibilities**

The Directors are responsible for preparing the Strategic Report, Directors' Report and the Company's financial statements (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;
- notify its members in writing about the use of disclosure exemptions, if any, of FRS 102 used in the preparation of financial statements; and

- 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.

At the date of this report, each individual Director states that he/she is not aware of any relevant audit information of which the Company's auditors are unaware, and each individual Director states that he/she has taken the steps he/she ought to have taken as set out in section 418(4) of the Companies Act 2006 as a Director to make himself/herself aware of any relevant audit information and establish whether the Company's auditors were aware of that information.

### **Statement of Going Concern**

The Board is satisfied after taking account of the Retrocession Agreement with HM Government that the Company has adequate financial resources to continue to operate for the foreseeable future which is, but not limited to, at least 12 months and is financially sound. For this reason, it considers the going concern basis appropriate for the preparation of financial statements.

### **Status of the Company**

The Company is a private company limited by guarantee, not having a share capital. Consequently, the Directors do not have any relevant interests that require disclosure.

The Company is authorised and regulated by the Prudential Regulation Authority and the Financial Conduct Authority.

The Company is not part of a group. It does not have any branches outside the United Kingdom. It does not have subsidiary undertakings.

### **Donations**

In the year under review the Company made no donations for political purposes (2015: £nil). A charitable donation of £19,450 (2015: £10,000) was made to Age UK.

### **Independent Auditors**

A key project for the Board and the Audit Committee in 2017 is the tender for the Company's external audit, a process which is in progress at the time of signing this year's financial statements. The appointment of the successor auditor will take effect for the Company's financial year ending 31 December 2017, subject to approval at the Company's AGM in June 2017. PricewaterhouseCoopers LLP (PwC) has been Pool Re's auditor since 1996. Given this length of tenure, in conjunction with new UK regulation concerning the rotation of audit firms, the Board has decided that PwC should not be asked to tender. On behalf of the Directors and the Audit Committee, we nonetheless take this opportunity to thank PwC for their professionalism and for the benefit which they have provided to the business during their tenure.

*By Order of the Board*



**Christian Wells**  
General Counsel and Company Secretary  
16 March 2017

## **STRATEGIC REPORT**

The Directors of Pool Reinsurance Company Limited (registered number 2798901) present their strategic report for the year ended 31 December 2016.

### **Review of the Business**

#### **Principal Activity**

During the year under review and since the year end there was no change in the principal activity of the Company which continued to be reinsurance business conducted on a mutual basis. Given the purpose for which the Company was formed, the Directors do not anticipate that the nature of the Company's business will change in the future. The unpredictability of terrorist events means that the Company is not in a position to make statements regarding likely future developments.

The Company provides reinsurance in respect of losses arising from damage to or destruction of commercial property resulting from Acts of Terrorism (as defined in the Reinsurance (Acts of Terrorism) Act 1993) within England, Wales and Scotland. The Company has a Retrocession Agreement with HM Government under the terms of which HM Government will make funds available in circumstances where the Company's assets are insufficient to meet all claims.

#### **Results and Performance**

Gross premium income for the year fell from £306.9m to £300.5m.

The balance on the general business technical account was £6.2m, a decrease of £135.4m from the 2015 result. The outward reinsurance premium payable to HM Government in respect of 2016 increased to £249.7m. There are two elements to this; £150.3m being 50% of Pool Re's gross written premiums and a further premium amount of £99.4m. The remaining £35.2m of outward reinsurance premium is in respect of external reinsurance protection which Pool Re purchased for the first time in 2015.

The terms of the revised retrocession agreement between Pool Re and Her Majesty's Treasury which took effect from 1 January 2015, include provision for Pool Re to pay an annual distribution to Members. The Board declared such a dividend on 28 June 2016 in respect of its 2015 results. The amount of the dividend paid was £33.5m.

Investment income including net realised and unrealised gains and losses amounted to £364.1m, reversing the 2015 net investment loss of £44.1m.

The amount allowed for taxation was £53.6m, relating to the United Kingdom corporation tax on investment income receivable and realised and unrealised profits, less interest payable and investment expenses. There is no taxation on the underwriting result as the business is conducted on a mutual basis.

The Company made a profit after taxation of £298.3m for the year ended 31 December 2016, increasing the accumulated balance on the profit and loss account available to meet future claims to £5.75bn.

The investment fund (financial investments, accrued income and investment cash) grew by £0.53bn in 2016 to a total value at 31 December 2016 of £6.26bn.

The UK was free of terrorist events in 2016 that might lead to claims for payment being made to the Company.

#### **Key Performance Indicators**

The level of participation in the Scheme is a factor by which the position of the Company's business can be measured. A profile of the Company's membership is set out on page 44.

Taking account of the other information provided in this report and notes to the financial statements, and in view of the special nature of the Company, there are no additional key performance indicators, nor environmental or employee matters that are considered necessary for an understanding of the Company's business.

## Principal Risks and Uncertainties

The Board is responsible for establishing effective risk governance and a system of internal control to safeguard the Company's assets and to ensure compliance with laws and regulations.

The Company operates a "three lines of defence" risk management and governance framework. The Board and the Executive Management form the first line of defence, responsible for ownership and management of risks that might impact upon the Company's objectives. The Enterprise Risk Management, Legal and Compliance functions form the second line of defence, responsible for providing guidance, oversight, and challenge around the business processes and risk management activities. The Internal Audit function forms the third line of defence and provides an independent assurance across the business. The Board has oversight over the second and third line of defence.

The framework incorporates various aspects of risk management and is used to co-ordinate the Company's overall approach to managing risk. The primary objective of this framework is:

- to support the development of the Company, but at the same time avoid unwelcome surprises by reducing uncertainty and volatility through the identification and management of risks to the achievement of strategies and objectives
- to optimise the risk by taking a balanced approach to risk and reward
- to embed Enterprise Risk Management throughout the activities of the business
- to ensure that risk ownership is allocated to appropriate senior management
- to assist the business in ensuring that appropriate controls are in place to mitigate the risks, including a process of continuous control assessment

The effectiveness of the Company's system of internal controls and its risk management framework are reviewed by an external provider of internal audit services, and reports on such reviews, including recommendations and management responses, are considered by the Board.

The Directors consider that the principal risks which face the Company, together with details of the control measures adopted by the Company are as follow:

Principal risk	Mitigating factors
<b>Insurance Risk</b>  The Company is exposed to insurance risk arising from inherent uncertainties as to the occurrence, amount and timing of its insurance liabilities.	<p>The Company's approach to the management of insurance risk reflects the commitments contained in the agreements which underpin the Pool Re scheme. The Company undertakes to accept all risks presented to it which meet the scheme criteria.</p> <p>Exposure to insurance risk is managed through controls to ensure, to the extent possible, that liquid funds are available to meet a claim or series of claims as and when necessary. In addition, there is no limit on the indemnity provided by HM Government under the terms of the Retrocession Agreement.</p> <p>This risk and its mitigations are described further in note 5(a) to the financial statements.</p>
<b>Market Risk</b>  The investment strategy exposes the Company to a range of financial risks arising from investing its assets against the contingency that they may be required in the short term to deal with a claim or series of claims, but	<p>Exposure to market risk is managed through the investment strategy which rests on the two main objectives for the fund of stability and liquidity, with the asset allocation aligned to these.</p> <p>The strategy is conservative designed to preserve capital and limit volatility from market fluctuations whilst still delivering an acceptable return.</p>

with recognition that they may not be called upon for long periods.	This risk and its mitigations are described further in note 5(b) to the financial statements.
<p><b>Credit Risk</b></p> <p>The Company is exposed to credit risk arising from a counterparty failing to perform its contractual obligations, including failure to perform them in a timely manner.</p>	<p>Exposure to credit risk predominately arises from investment and commercial reinsurance contracts. These exposures are managed through use of high quality counterparties and setting appropriate limits to investment with individual or group counterparties and reinsurance counterparties.</p> <p>This risk and its mitigations are described further in note 5(b) to the financial statements.</p>
<p><b>Liquidity Risk</b></p> <p>The Company is exposed to liquidity risk through its investment strategy, investing in securities with a range of maturities and cash flows.</p>	<p>Exposure to liquidity risk is managed through holding assets in high quality liquid funds, meeting any cash outflow by using its existing funds and then drawing on unlimited support provided by HM Treasury.</p> <p>This risk and its mitigations are described further in note 5(b) to the financial statements.</p>
<p><b>Operational Risk</b></p> <p>The Company is exposed to operational risk where failure in relation to people, processes, systems and external factors, including conduct risk, jeopardise the operation of the Pool Re scheme.</p>	<p>Exposure to operational risk is managed by ensuring that there are effective processes, systems and controls throughout the Company. Arrangements with outsource providers are monitored and their appropriateness assessed periodically. The Company maintains a strong and open relationship with its regulators and embraces a good conduct culture.</p> <p>Legal advice is obtained periodically to review the Company's position in relation to Chapter 1 of the Competition Act 1998, to determine that the Scheme continues to meet the exemption requirements set out in that Act.</p>

By Order of the Board



**Christian Wells**  
General Counsel and Company Secretary  
16 March 2017

## **Independent Auditors' Report to the Members of Pool Reinsurance Company Limited**

### **Report on the financial statements**

#### **Our opinion**

In our opinion, Pool Reinsurance Company Limited's financial statements (the "financial statements"):

- give a true and fair view of the state of the company's affairs as at 31 December 2016 and of its profit and cash flows for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

#### **What we have audited**

The financial statements, included within the Annual Report, comprise:

- the Balance Sheet as at 31 December 2016;
- the Profit and Loss Account for the year then ended;
- the Statement of Changes in Equity for the year then ended;
- the Statement of Cash Flows 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 the preparation of the financial statements is United Kingdom Accounting Standards, comprising FRS 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland", and applicable law (United Kingdom Generally Accepted Accounting Practice).

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.

#### **Opinions on other matters prescribed by the Companies Act 2006**

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the Strategic Report and the Directors' Report have been prepared in accordance with applicable legal requirements.

In addition, in light of the knowledge and understanding of the company and its environment obtained in the course of the audit, we are required to report if we have identified any material misstatements in the Strategic Report and the Directors' Report. We have nothing to report in this respect.

#### **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 Statement of the Directors' Responsibilities, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view.

Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland) ("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.

### **What an audit of financial statements involves**

We conducted our audit in accordance with 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.

We primarily focus our work in these areas by assessing the directors' judgements against available evidence, forming our own judgements, and evaluating the disclosures in the financial statements.

We test and examine information, using sampling and other auditing techniques, to the extent we consider necessary to provide a reasonable basis for us to draw conclusions. We obtain audit evidence through testing the effectiveness of controls, substantive procedures or a combination of both.

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. With respect to the Strategic Report and Directors' Report, we consider whether those reports include the disclosures required by applicable legal requirements.



Marcus Hine (Senior Statutory Auditor)  
for and on behalf of PricewaterhouseCoopers LLP  
Chartered Accountants and Statutory Auditors  
London  
16 March 2017

- The maintenance and integrity of the Pool Reinsurance Company Limited website is the responsibility of the directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website.
- Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

**Profit and Loss Account**

**Technical account - General business  
for the 12 months to 31 December 2016**

	<u>Notes</u>	<u>2016</u> <u>£000</u>	<u>2015</u> <u>£000</u>
Gross premiums written	6	300,503	306,926
Outward reinsurance premiums	6	(284,865)	(220,630)
<b>Net premiums written</b>		<u>15,638</u>	<u>86,296</u>
Change in the gross provision for unearned premiums		(995)	(756)
Change in the provision for unearned premiums, reinsurers' share		798	64,571
<b>Earned premiums, net of reinsurance</b>		<u>15,441</u>	<u>150,111</u>
Claims paid - gross amount		(2,270)	(6,479)
Change in provision for claims - gross amount		3,555	6,640
<b>Claims incurred, net of reinsurance</b>		<u>1,285</u>	<u>161</u>
Net operating expenses	7	(10,536)	(8,707)
<b>Balance on the general business technical account</b>		<u>6,190</u>	<u>141,565</u>

The above results all relate to continuing operations and to risks located in the United Kingdom.  
Company number : 2798901

The notes on pages 22 to 43 form an integral part of these financial statements.

**Profit and Loss Account**

**Non-technical account  
for the 12 months to 31 December 2016**

	<u>Notes</u>	<u>2016</u> <u>£000</u>	<u>2015</u> <u>£000</u>
<b>Balance on the general business technical account</b>		6,190	141,565
<b>Investment income</b>			
Income from financial assets at fair value through profit and loss	10	126,683	125,172
Net losses on the realisation of investments	10	<u>(231,831)</u>	<u>(12,231)</u>
<b>Investment income</b>		<u>(105,148)</u>	<u>112,941</u>
Net unrealised gains/(losses) on investments	10	469,206	(157,012)
Investment expenses and charges	10	<u>(18,275)</u>	<u>(12,458)</u>
<b>Profit on ordinary activities before tax</b>		<u>351,973</u>	<u>85,036</u>
Tax on profit on ordinary activities	11	(53,636)	15,496
<b>Profit for the financial year after tax</b>		<u>298,337</u>	<u>100,532</u>
<b>Profit for the financial year transferred to Profit and Loss Account reserves</b>		<u><u>298,337</u></u>	<u><u>100,532</u></u>

The above results all relate to continuing operations.

There were no amounts recognised in other comprehensive income in the current or preceding year other than those included in the statement of profit or loss. Therefore no statement of other comprehensive income has been presented.

Company number : 2798901

The notes on pages 22 to 43 form an integral part of these financial statements.

**Balance Sheet**  
as at 31 December 2016

	<u>Notes</u>	<u>2016</u> £000	<u>2016</u> £000	<u>2015</u> £000	<u>2015</u> £000
<b>ASSETS</b>					
<b>Investments</b>					
Other financial investments	12		6,259,642		5,727,516
<b>Reinsurers' share of technical provisions</b>					
Provision for unearned premiums	17		80,071		79,273
<b>Debtors</b>					
Debtors arising out of reinsurance operations	15	76,648		75,820	
Other debtors	16	<u>4,242</u>		<u>7,910</u>	
			80,890		83,730
<b>Other assets</b>					
Tangible assets	13	265		252	
Cash at bank and in hand	14	<u>47,831</u>		<u>52,616</u>	
			48,096		52,868
<b>Prepayments and accrued income</b>					
Accrued interest		33,206		36,308	
Other prepayments		<u>602</u>		<u>375</u>	
			33,808		36,683
<b>Total assets</b>			<u><u>6,502,507</u></u>		<u><u>5,980,070</u></u>
<b>LIABILITIES</b>					
<b>Capital and reserves</b>					
Profit and Loss Account	22		5,745,912		5,481,086
<b>Financial liabilities</b>					
Other financial investments	12		74,147		82,996
<b>Technical provisions</b>					
Provision for unearned premiums	17	148,774		147,779	
Claims outstanding		<u>-</u>		<u>3,555</u>	
			148,774		151,334
<b>Provisions for other risks</b>	18		483,247		224,925
<b>Creditors</b>					
Creditors arising out of reinsurance operations	19	33,485		32,707	
Other creditors including taxation and social security	20	14,543		5,044	
<b>Accruals and deferred income</b>		<u>2,399</u>		<u>1,978</u>	
			50,427		39,729
<b>Total liabilities</b>			<u><u>6,502,507</u></u>		<u><u>5,980,070</u></u>

The financial statements on pages 17 to 43 were approved by the Board of Directors on 16 March 2017 and signed on its behalf by:



**Geoffrey M Riddell**  
Chairman



**Peter J Box**  
Director

Company number : 2798901

The notes on pages 22 to 43 form an integral part of these financial statements.

**Statement of Changes in Equity  
for the 12 months to 31 December 2016**

	<u>Notes</u>	<u>2016</u> <u>£000</u>	<u>2015</u> <u>£000</u>
<b>Profit and Loss Account reserves as at the beginning of the year</b>		5,481,086	5,380,554
Profit for the year		298,337	100,532
Dividend paid	23	(33,511)	-
<b>Profit and Loss Account reserves as at the end of the year</b>		<u>5,745,912</u>	<u>5,481,086</u>

The notes on pages 22 to 43 form an integral part of these financial statements.

**Statement of Cash Flows**  
**for the 12 months to 31 December 2016**

	<u>Notes</u>	<u>2016</u> <u>£000</u>	<u>2015</u> <u>£000</u>
<b>Net cash from operating activities</b>	21	224,006	212,396
Taxation paid		(18,941)	(3,064)
Interest paid		(2,379)	(2,542)
<b>Net cash generated from operating activities</b>		<u>202,686</u>	<u>206,790</u>
<b>Cash flow from investing activities</b>			
Purchases of tangible assets		(145)	(89)
Interest received		129,785	125,916
Proceeds from sale of other financial investments		12,342,124	8,552,386
Purchase of other financial investments		(12,450,694)	(8,761,995)
<b>Net cash generated from / (used in) investing activities</b>		<u>21,070</u>	<u>(83,782)</u>
<b>Net cash used in financing activities</b>			
Dividend paid		(33,511)	-
<b>Net increase in cash and cash equivalents</b>		<u>190,245</u>	<u>123,008</u>
Cash and cash equivalents at beginning of the year		455,300	332,292
<b>Cash and cash equivalents at end of the year</b>		<u><u>645,545</u></u>	<u><u>455,300</u></u>
 Cash and cash equivalents consist of:			
Cash at bank and in hand		47,831	52,616
Short term deposits presented within other financial investments		597,714	402,684
<b>Cash and cash equivalents</b>		<u><u>645,545</u></u>	<u><u>455,300</u></u>

The notes on pages 22 to 43 form an integral part of these financial statements.

## Notes to the financial statements for the year ended 31 December 2016

### 1 General Information

The Company is a mutual company limited by guarantee, incorporated in England and Wales, with its principal place of business at 5 Lloyd's Avenue, London, EC3N 3AE. Its principal activity continues to be reinsurance in respect of losses arising from damage to, or destruction of commercial property resulting from Acts of Terrorism within England, Wales and Scotland.

### 2 Statement of Compliance

The Company's financial statements have been prepared in compliance with United Kingdom Accounting Standards, including Financial Reporting Standard 102, "The Financial Reporting Standard applicable in the United Kingdom and the Republic of Ireland" (FRS 102), Financial Reporting Standard 103, "Insurance Contracts" (FRS 103) and the Companies Act 2006. The financial statements have been prepared in compliance with the provisions of the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations relating to insurance companies.

FRS 102 gives an accounting policy choice for financial instruments, namely:

- (a) apply the provisions of FRS 102 in full;
- (b) apply the recognition and measurement provisions of IAS 39 (as adopted by the European Union) and the disclosure requirements of FRS 102; or
- (c) apply the recognition and measurement provisions of IFRS 9 and/or IAS 39 (as amended following the publication of IFRS 9) and the disclosure requirements of FRS 102.

The Company has elected to apply the recognition and measurement provisions of IAS 39 (as adopted by the European Union) and the disclosure requirements of FRS 102 in respect of financial instruments.

On 8 March 2016 the Financial Reporting Council (FRC) released its amendment to the levelling definitions for fair value hierarchy disclosures. The amendment reverts back to levels consistent with IFRS 13 (old IFRS 7) and whilst effective from 1 January 2017, early application is permitted. The new definition is as follows:

Level 1: The unadjusted quoted price in an active market for identical assets or liabilities that the entity can access at the measurement date.

Level 2: Inputs other than quoted prices included within Level 1 that are observable (i.e. developed using market data) for the asset or liability, either directly or indirectly.

Level 3: Inputs are unobservable (i.e. for which market data is unavailable) for the asset or liability.

The Company has chosen to adopt this amendment to the standard.

### 3 Summary of Significant Accounting Policies

The principal accounting policies applied in the preparation of these financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

#### (a) Basis of preparation

The preparation of financial statements in conformity with FRS 102 and FRS 103 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. Any areas involving a high degree of judgement or complexity, or areas where assumptions and estimates are significant to the financial statements, are disclosed in note 4.

**Notes to the financial statements for the year ended 31 December 2016**

**(b) Going concern**

Having assessed the principal risks, the directors consider it appropriate to adopt the going concern basis of accounting in preparing the financial statements.

**(c) Functional and presentational currency**

The Company's financial statements are presented in pound sterling and rounded to thousands.

The Company's functional currency is the pound sterling.

**(d) Foreign currency**

Foreign currency transactions are translated into UK pounds sterling using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the Profit and Loss Account for the period.

Translation differences on non-monetary items, such as equities held at fair value through the Profit and Loss Account, are reported as part of the fair value gain or loss.

**(e) Insurance contracts**

The Company's financial position and its obligations to meet claims under its agreements with Members are assured in that the Company has entered into a Retrocession Agreement with HM Government under which the Company would draw funds from HM Government if claims were to exceed the Company's resources. The Retrocession Agreement specifies circumstances in which amounts paid by HM Government will be subject to repayment by the Company. However, in certain circumstances when the Retrocession Agreement is terminated, HM Government is not entitled to repayment of amounts it has paid to the Company.

Premium is payable to HM Government for providing retrocession cover only when the funds standing to the credit of the Insurance Fund and the Investment Fund, as defined by the Retrocession Agreement, exceed £1bn. These funds are broadly equivalent to premiums received, investment income earned and investment gains, less investment losses, incurred claims, taxation and expenses, subject to certain differences in the timing of their recognition. The retrocession premium may become immediately payable, in certain circumstances, if the Company fails to comply with the conditions of the Retrocession Agreement.

The Company has reviewed the nature of the inwards and outwards reinsurance business it transacts. It is satisfied that all such business falls within the definition of Insurance Risk and has therefore treated the relevant contracts as insurance contracts for the purposes of these financial statements. All premiums disclosed in the Profit and Loss Account relate to standard insurance contracts.

**(i) Technical results**

The technical results are determined using the annual basis of accounting whereby the incurred costs of claims and expenses are charged against the earned proportion of premiums, net of reinsurance.

**(ii) Premiums written**

Premiums written relate to business that incepted during the year, together with any difference between booked premiums for prior years and those previously accrued, and include estimates of premiums due but not yet receivable or notified to the Company. Where written premiums are subject to subsequent adjustment, reductions are made as soon as they are foreseen, however, potential increases are not recognised until the amount can be determined with reasonable certainty. Additional or return premiums are treated as adjustments to gross written premiums.



**Notes to the financial statements for the year ended 31 December 2016**

**(iii) Unearned premiums**

Unearned premiums represent the proportion of premiums written in the year that relate to unexpired terms of policies in force at the balance sheet date, calculated on a time apportionment basis.

The unearned premiums calculation has been carried out using the most appropriate basis available, which is considered to be the eighths basis. This basis assumes premium received for a particular quarter represents policies which incept, on average, at the mid-point of the quarter. Thus 1/8 of the premium for the first quarter, 3/8 of the premium for the second quarter, 5/8 of the premium for the third quarter and 7/8 of the premium for the fourth quarter is unearned at 31 December.

The Company calculates unearned premiums in respect of its gross written premiums and also in respect of the commercial retrocession it has purchased.

**(iv) Claims incurred**

Claims incurred comprise claims and related expenses paid in the year and changes in the provisions for outstanding claims, including provisions for claims incurred but not reported and related expenses, together with any other adjustments to claims from previous years. Where applicable, deductions are made for salvage and other recoveries.

**(v) Claims provisions and reinsurance recoveries**

Provision is made at the year end for the estimated cost of claims incurred but not settled at the balance sheet date, including the cost of claims incurred but not yet reported to the Company. The Company takes all reasonable steps to ensure that it has appropriate information regarding its claims exposures. However, given the uncertainty in establishing claims provisions, it is likely that the final outcome will prove to be different from the original liability established.

In estimating the cost of claims notified but not paid, the Company has regard to the cost of claims incurred by Members, both within and in excess of each Member's retention. The overall emerged claims cost is closely managed by the Company.

The nature of the underlying business is such that there is unlikely to be a significant delay between the occurrence of a claim and the claim being reported. However, there can be significant delays in assessing the Company's ultimate liability for such claims. Claims notified to the Company at the balance sheet date are estimated on a basis that reflects the current position for Members' liabilities to their policyholders, less Members' retentions.

Provisions are calculated gross of any reinsurance recoveries. A separate estimate is made of the amounts that may be recoverable from reinsurers based upon the gross provisions and having due regard to collectability.

**(vi) Outward reinsurance premiums**

Provision is made for outwards reinsurance premiums payable to HM Government under the terms of the Retrocession Agreement and to other commercial reinsurers.

**Notes to the financial statements for the year ended 31 December 2016**

**(f) Employee benefits**

The Company provides a range of benefits to employees, including a defined contribution pension plan, annual bonus arrangements and long-term incentive plans for members of senior management.

**(i) Short-term benefits**

Short-term benefits, including holiday pay, are recognised as an expense in the period in which the service is received.

**(ii) Defined contribution pension plan**

The Company operates a defined contribution plan for its employees. A defined contribution plan is a pension plan under which the Company pays a fixed contribution into a separate entity. Once the contributions have been paid, the Company has no further payment obligations. The contributions are recognised as an expense when they are due. Amounts not paid are shown in accruals in the balance sheet. The assets of the plan are held separately from the Company in an independently administered fund.

**(iii) Annual bonus arrangements**

The Company operates annual bonus plans for employees. An expense is recognised in the Profit and Loss Account when the Company has a legal or constructive obligation to make payments under the plans as a result of past events and a reliable estimate of the obligation can be made.

**(iv) Long-term incentive plans**

The Company operates cash-settled long-term incentive plans for members of senior management. The plans are based on an individual's personal targets in developing the business and deferred over a period of in excess of three years. Payment may be reduced or forfeited in instances where an individual leaves employment or a material risk event occurs. An expense is recognised in the Profit and Loss Account for the estimated maximum amount payable in respect of the incentive plans.

**(g) Expenses**

Capital expenditure on computer equipment and office equipment is depreciated by equal instalments over the estimated useful lives of the assets. Expenditure on computer software is written off as incurred.

All expenses are recognised on an accruals basis and, other than investment expenses, are charged to the technical account.

**(h) Taxation**

Taxation is charged on investment income receivable and realised and unrealised gains, less interest payable and investment expenses, for the period. Current tax is the expected tax payable on the taxable income for the period using tax rates enacted or substantively enacted at the reporting date and adjustments to tax payable in prior periods.

Deferred tax is recognised in respect of all material timing differences that have originated but not reversed at the balance sheet date, where transactions or events that result in an obligation to pay more tax in the future or a right to pay less tax in the future have occurred at the balance sheet date, including revaluation gains and losses on investments recognised in the Profit and Loss Account.

A net deferred tax asset is recognised as recoverable and therefore recognised only when, on the basis of all available evidence, it can be regarded as more likely than not that there will be suitable taxable profits against which to recover carried forward tax losses and from which the future reversal of underlying timing differences can be deducted.

Deferred tax is measured at the average tax rates that are expected to apply in the periods in which the timing differences are expected to reverse, based on tax rates and laws that have been enacted or substantively enacted by the balance sheet date. Deferred tax is measured on an undiscounted basis.

**Notes to the financial statements for the year ended 31 December 2016**

**(i) Tangible assets**

Tangible assets are stated at historical purchase cost less accumulated depreciation and any impairment loss. Depreciation is calculated to write off the costs of tangible assets, less their residual values, over their expected useful lives using the straight line basis. Furniture and fixtures are depreciated over five years and computer and telephone equipment over two years. At each balance sheet date, tangible assets are reviewed to determine whether there is an indication that the asset may be impaired. If there is such an indication, the recoverable amount of the asset is compared to the carrying amount of the asset and, where necessary, the carrying amount is adjusted accordingly.

Additions are included at their original purchase price plus any costs directly attributable to bringing the asset to its working condition for its intended use. Tangible assets are derecognised on disposal or when no future economic benefits are expected. On disposal, the difference between the net disposal proceeds and the carrying amount is recognised in the Profit and Loss Account.

**(j) Leased assets**

Leases where a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Rents payable under operating leases are charged to the Profit and Loss Account as incurred over the non-cancellable lease term.

**(k) Cash and cash equivalents**

Cash and cash equivalents include cash in hand, deposits held at call with banks and other short-term highly liquid investments with original maturities of three months or less.

**(l) Provisions for other risks**

Outward reinsurance to HM Government is provided for in accordance with the terms of the Retrocession Agreement between the Company and HM Government. The outward reinsurance is payable no later than 31 March in the fourth year after the year to which the gross premium written relates. At the balance sheet date the outward reinsurance presents a contractual obligation as a result of previous premiums received and can be reliably estimated.

**Notes to the financial statements for the year ended 31 December 2016**

**(m) Financial assets and liabilities**

The Company has elected to apply the recognition and measurement provision of IAS 39 (as adopted for use in the EU) and the disclosure requirements of sections 11 and 12 of FRS 102 in respect of financial instruments.

Under IAS 39, financial assets and liabilities are classified in one of the following categories:

- (a) Financial assets at fair value through profit or loss
- (b) Available-for-sale financial assets
- (c) Loans and receivables
- (d) Held-to-maturity investments

The Company accounts for all financial assets and liabilities at fair value through profit or loss.

The Company recognises a financial asset or liability at the time it becomes a party to the instruments' contractual provisions. When a financial asset or liability is recognised initially, the Company measures it at its fair value (excluding transactions costs). Fair value is the amount for which an asset is exchanged, or a liability settled.

After initial recognition, the Company measures financial assets and liabilities, including derivatives, at their fair values, without any deduction for transaction costs it may incur on sale or other disposal. All unrealised gains and losses on financial assets that are measured at fair value are taken to the Profit and Loss Account.

Derecognition of a financial asset occurs only when the Company has transferred the asset's risk and rewards (either substantially or partially) or control of the contractual rights have been transferred from the seller to the buyer. On derecognition, realised gains and losses, being the difference between the amount received and the asset's carrying amount, are recognised in the Profit and Loss Account.

Derecognition of financial liabilities focus solely on the legal release of the contractual obligations. On derecognition, realised gains and losses, being the difference between the consideration paid and the liability's carrying amount, are recognised in the Profit and Loss Account.

The carrying values of debtors, prepayments and accrued income are reported at the transaction price.

The carrying values of creditors, accruals and deferred income are assumed to approximate to their fair values due to the short-term nature of the liabilities.

**(n) Other Debtors**

Receivables are recognised and carried at the lower of their originally invoiced value and recoverable amount. Where the time value of money is material the receivables are carried at amortised cost. Provisions are made where there is objective evidence that the amount will not be recovered in full.

**(o) Investment return**

Investment income, which is all included in the non-technical account, is determined on an accruals basis. Realised gains or losses represent the difference between net sales proceeds and the purchase price. Movements in unrealised gains and losses on investments represent the difference between the fair value at the balance sheet date and the purchase price or, if previously valued, the fair value at the previous balance sheet date.

Adjustments are made in respect of investments realised during the year where unrealised gains or losses were previously recognised in the Profit and Loss Account.

Dividend income is recognised when the right to receive payment is established.

**Notes to the financial statements for the year ended 31 December 2016**

**(p) Distributions**

Distributions to the Company's Members are calculated in accordance with the terms of the Retrocession Agreement between the Company and HM Government and are recognised in the financial statements for the period in which the distributions are declared and paid.

**(q) Related party transactions**

Where the Company has entered into related party transactions, the nature of the related party relationship as well as information about the transactions, outstanding balances and commitments necessary for an understanding of the potential effect of the relationship on the financial statements is disclosed in the notes to the financial statements.

**4 Critical Accounting Judgements and Estimation Uncertainty**

Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

Significant judgement is required to categorise financial assets and liabilities under the fair value hierarchy classifications defined in FRS 102. The Company exercises judgement in determining whether a market is active and if valuations in these markets reliably reflect the price of an arm's length transaction. The fair value of financial instruments that are not traded in an active market is determined by using valuation techniques utilising observable and unobservable inputs. The risks related to these judgements are set out in note 5 below.

There are currently no other significant judgements to disclose in connection with applying the accounting policies.

## Notes to the financial statements for the year ended 31 December 2016

## 5 Management of Insurance and Financial Risk

## (a) Insurance risk

The risk under any one insurance contract is the possibility that the insured event occurs and the uncertainty of the amount of the resulting claim. By the very nature of an insurance contract, this risk is unpredictable.

The Company's approach to the management of insurance risk is influenced by the commitments contained in the agreements which form the foundations of the Company scheme. The Company undertakes to accept all risks presented to it which meet the criteria of the scheme and has a Retrocession Agreement with HM Government providing unlimited funding where it faces claims beyond the extent of its ability to pay from its own resources. Under the PRA capital regime the Company has a capital resource requirement set equal to zero. These arrangements are designed to ensure that the Company can accept all exposures presented to it without limit.

In turn, these arrangements ensure that the Company can provide primary insurers with the reinsurance protection they need to enable them to provide terrorism cover to all clients upon request to the full extent of their policy programme. Hence it is not an objective to limit the assumption of insurance risk but to ensure that:

- risks accepted fall within the criteria set by the scheme and fall within the scope of the Retrocession Agreement
- pricing is adequately fair between the Members of the scheme and
- adequate administration arrangements are in place in the event of a major claim.

The Company's appetite for insurance risk is therefore unlimited, provided that losses will ultimately be met by its funds and its retrocessional cover. Its policy is to assume all relevant risks presented to it whilst ensuring that it accepts only risks falling within the criteria set by the scheme.

The Company has however reduced its sensitivity to insurance risk through the continuation of the three year rolling contract to purchase commercial retrocession protection. This contract is annually cancellable at the Company's option, or at the reinsurers' option if they are in deficit. The cover is in two layers totalling £1,950 million with an attachment point of £500million. Cover is subject to an average of 4.3% co-insurance. The price paid for the period 1 March 2016 to 28 February 2017 of £ 35.1m includes broker commission and equates to a signed rate on line of 1.88. The reinsurance cover is fully back to back with the cover the Company provides to Members. The minimum credit rating accepted is A- and the contract incorporates a downgrade clause allowing the Company to remove a reinsurer if its rating is downgraded.

The table below shows claims outstanding at the end of the reporting year. Significant controls are in place to ensure, to the extent possible, that liquid funds are available to meet claims or a series of claims as and when necessary.

## Claim Development table

Reporting year	2012 £000	2013 £000	2014 £000	2015 £000	2016 £000	
<b>Estimate of ultimate claims costs:</b>						
- At end of reporting year	-	14,810	-	-	-	
- One year later	-	15,060	-	-	-	
- Two years later	-	14,899	-	-	-	
- Three years later	-	13,614	-	-	-	
- Four years later	-	-	-	-	-	
<b>Reporting year</b>	<b>2012 £000</b>	<b>2013 £000</b>	<b>2014 £000</b>	<b>2015 £000</b>	<b>2016 £001</b>	<b>Total £000</b>
<b>Current position:</b>						
Current estimate of cumulative claims	-	13,614	-	-	-	13,614
Cumulative payments to date	-	(13,614)	-	-	-	(13,614)
Liability recognised in the balance sheet	-	-	-	-	-	-

There are currently no claims outstanding or reinsurers' share of claims outstanding.

## Notes to the financial statements for the year ended 31 December 2016

### (b) Financial risk management objectives

The overall financial risk management objective is to invest the Company's assets against the contingency that they may be required in the short term to deal with a claim or series of claims, but with recognition that they may not be called upon for long periods.

The Company has adopted risk policies to address the management of its investment risks and there are procedures in place to identify, assess and manage the risks faced by the Company.

The Board has set an investment strategy and has employed a number of independent investment managers under specific mandates to administer the Company's investments. In addition, the Company has an Investment Committee which considers all aspects of the Company's investment activity and, where appropriate, makes recommendations to the Board.

The agreed investment strategy rests on the two main objectives for the fund of stability and liquidity, with the asset allocation aligned to these. Two stability risk measures and two liquidity risk measures have been adopted and risk budgets have been agreed in respect of each measure.

The investment portfolio is diversified and the investment policy sets limits on the Company's exposure to various types of investment. There is a formal process to review regularly and, where appropriate, rebalance the asset allocation towards the target allocation.

Reports on investment performance are considered at the quarterly Investment Committee meetings and as a standing item in the Company's quarterly Board meetings. Contact is maintained throughout the year with each investment manager and the custodians. The Company meets regularly with the investment managers and the custodians and there is a process for considering and resolving any operational issues which arise.

Derivative contracts are used by the Company only for the purposes of efficient portfolio management. Hence, derivatives are used to reduce risk, to reduce cost or to generate additional capital or income at no, or an acceptably low, level of risk.

The Company is exposed to a range of financial risks through its financial assets, financial liabilities and policyholder liabilities, the most important of which are market (equity price, commodity price, interest rate and currency), credit and liquidity risk.

#### (i) Market risk

##### Equity price risk

The Company is exposed to equity securities price risk as a result of changes in the value of its holdings in equity investments which are included within financial assets at fair value. At the year end the Company held £618,178k (2015: £555,685k) in equity shares. This comprised 10.0% (2015: 9.9%) of the total financial investments.

In order to mitigate its exposure to the risk of changes in the prices of individual equities, the Company has a broadly diversified portfolio of global equities which are managed on a passive basis against well established market indices.

If equity market indices had increased/decreased by 30%, with all other variables held constant, and all the Company's equity investments moving according to the historical correlation with the index, the profit for the year would increase/decrease by £191,557k (2015: £166,706k).

##### Commodity price risk

The Company is exposed to commodity price risk as a result of changes in the value of its holdings in commodity investments which are included within financial assets at fair value. At the year end the Company held £166,262k (2015: £126,236k) in units in commodity unit trusts. This comprised 2.7% (2015: 2.2%) of the total financial investments.

If commodity market indices had increased/decreased by 30%, with all other variables held constant, and all the Company's commodity investments moving according to the historical correlation with the index, the profit for the year would increase/decrease by £49,879k (2015: £37,871k).

**Notes to the financial statements for the year ended 31 December 2016**

**Interest rate risk**

The Company is exposed to interest rate risk which arises primarily from investments in fixed interest securities. At the year end, the value of the Company's holdings of financial assets and liabilities reported within other financial investments exposed to interest rate risk was £5,499,996k (2015: £5,021,582k) and £6,872k (2015: £104k) respectively.

The Company uses certain derivatives to mitigate this interest rate risk. Investments in derivatives are governed by specific provisions within the investment mandates and can only be made for the purposes of efficient portfolio management.

Modified duration has been used as the measure of the sensitivity to changes in interest rates of the Company's fixed interest portfolio. Modified duration is the weighted average of the duration of each holding in the portfolio taking account of the key characteristics of coupon, maturity and cash flows. Since September 2011 a long gilt futures contract has been used to reduce modified duration in the portfolio. At 31 December 2016 the average modified duration of the fixed interest portfolio, including index-linked government bonds, without taking account of the gilt futures was 2.36 years (2015: 1.72 years). The effect of the gilt futures contracts was to reduce the fixed interest portfolio average modified duration to 1.86 years (2015: 1.23 years).

The sensitivity analysis for interest rate risk illustrates how changes in the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates at the reporting date. An increase/decrease of 50 basis points in interest yields would result in a decrease/increase in profit for the period of £50,554k (2015: £35,190k) assuming all other assumptions remain unchanged.

The Company is also exposed to interest rate risk on financial liabilities relating to reinsurance operations. The value of financial liabilities relating to reinsurance operations exposed to interest rate risk at year end was £486,621k (2015: £257,556k). This exposure relates to outward retrocession premium payable to HM Government of £33,479k (2015: £32,631k) and provisions for other risks of £453,142k (2015: £224,925k).

The Company incurred an average interest rate of 2.50% (2015: 2.56%) on financial liabilities relating to reinsurance operations in 2016. An increase/decrease of 50 basis points in interest rates would result in a decrease/increase in profit for the period of £1,250k (2015: £1,288k).

**Currency risk**

The Company is exposed to currency risk in respect of investments denominated in a currency other than Sterling.

The Company's policy is to manage its exposure to non-Sterling denominated debt securities and fixed income assets through the use of forward contracts.

At the end of the year the value of assets denominated in currencies other than Sterling not covered by foreign exchange contracts within the portfolios was £689,366k (2015: £704,499k). If Sterling had weakened/strengthened by 25% against the mix of currencies within the uncovered portion of the Company's investment fund, with all other variables held constant, profit for the year would have been £172,342k (2015: £176,125k) higher/lower, mainly as a result of foreign exchange gains/losses on the translation of foreign currency denominated financial assets, carried at fair value through profit or loss.



**Notes to the financial statements for the year ended 31 December 2016**

The table below shows the impact on profit from changes in foreign currency exchange rates of 25% against Sterling on the Company's top five currency exposures.

Currency	<u>2016</u>		<u>2015</u>	
	Fair value of asset £000	Increase / decrease in profits £000	Fair value of asset £000	Increase / decrease in profits £000
CAD	20,299	5,075	17,241	4,310
EUR	84,907	21,227	76,804	19,201
HKD	30,838	7,710	27,946	6,987
JPY	75,631	18,908	60,545	15,136
USD	352,218	88,054	408,695	102,174
	<u>563,893</u>	<u>140,974</u>	<u>591,231</u>	<u>147,808</u>

**(ii) Credit risk**

Credit risk arises from the failure of a counterparty to perform its financial obligations or a failure to perform those obligations in a timely manner. The Company's investment policies are designed to restrict the level of credit risk in the fund by setting limits on individual investments or groups of investments. Such limits are set by reference to the credit ratings determined by established credit rating agencies and individual issuer limits.

The Company assesses the condition and creditworthiness of financial depositories by reviewing credit grades provided by rating agencies and other publicly available information. The Company also places limits on the level of counterparty exposure to financial depositories.

The total exposure of the investment fund to credit risk at the year end was £5,481,376k (2015: £5,050,546k), representing the total value of bonds, commercial paper, loans, derivative financial instruments, deposits with credit institutions and cash at bank and in hand. Of this total, 60% (2015: 62%) was invested in UK Government Gilts and other AAA/AA rated securities. A full analysis is set out below:

	<u>2016</u> £000	<u>2015</u> £000
Derivative financial instruments	(58,046)	(73,110)
Debt securities	4,866,643	4,643,503
Loans	25,126	24,310
Deposits with credit institutions	599,822	403,227
Cash at bank and in hand	47,831	52,616
<b>Total assets bearing credit risk</b>	<u>5,481,376</u>	<u>5,050,546</u>

	<u>2016</u> %	<u>2015</u> %
AAA	17	6
AA	43	56
A	27	23
BBB	8	10
BB	2	1
B	2	1
Not rated	1	3
<b>Total assets bearing credit risk</b>	<u>100</u>	<u>100</u>

## Notes to the financial statements for the year ended 31 December 2016

At the balance sheet date, excluding UK Government Gilts and US Government Securities, the maximum credit risk exposure to a single counterparty amounted to less than 1% of the Net Asset Value (2015: less than 1%).

Initial margin requirements for derivative financial instruments at year end were £8,783k, of which £6,511k is provided in the form of government-issued securities held within the Company's investment fund, in which the Company retains beneficial ownership. The Company has posted cash collateral in respect of foreign exchange derivatives of £10,508k.

The Company receives reports from its investment managers detailing any breaches of mandates including those resulting from defaults and past due items. No financial assets of material value were past due or impaired at the year end.

With regard to the credit risk associated with the debtors arising from reinsurance operations, all material balances outstanding at the year end were fully paid by the end of February 2017.

### (iii) Liquidity risk

As stated above, the Company's overall financial risk management objective is to invest the assets against the contingency that they may be required in the short term to deal with a claim or series of claims, but with recognition that they may not be called upon for long periods. In respect of short-term liquidity, the benchmark investment portfolio provides for 44% of the Company's total investment assets to be self-liquidating within 18 months, comprising bonds with maturities of less than 18 months. At 31 December 2016, 44% (2015: 63%) of the Company's investment assets were held in bonds with maturities of less than 18 months.

The Company has financial liabilities shown on the face of the Balance Sheet in respect of creditors, foreign exchange derivatives, interest rate swaps and credit default swaps. The table below is a maturity analysis of the Company's financial liabilities. Cash flows in respect of derivative liabilities are shown on an undiscounted basis.

### Financial liabilities and outstanding claims as at 31 December 2016

	Within 1 year £000	Between 1 year and 2 years £000	Between 2 years and 5 years £000	Over 5 years £000	Total £000
Deposits with credit institutions	243	-	-	-	243
Derivatives	73,904	-	-	-	73,904
	74,147	-	-	-	74,147
Claims outstanding	-	-	-	-	-
Provisions for other risks	-	197,890	255,252	-	453,142
Creditors arising from reinsurance operations	33,485	-	-	-	33,485
Other creditors including taxation and social security	14,543	-	-	-	14,543
	122,175	197,890	255,252	-	575,317

**Notes to the financial statements for the year ended 31 December 2016**

**Financial liabilities and outstanding claims as at 31 December 2015**

	Within 1 year £000	Between 1 year and 2 years £000	Between 2 years and 5 years £000	Over 5 years £000	Total £000
Deposits with credit institutions	244	-	-	-	244
Derivatives	82,752	-	-	-	82,752
	82,996	-	-	-	82,996
Claims outstanding	3,555	-	-	-	3,555
Provisions for other risks	-	32,656	192,269	-	224,925
Creditors arising from reinsurance operations	32,707	-	-	-	32,707
Other creditors including taxation and social security	5,044	-	-	-	5,044
	124,302	32,656	192,269	-	349,227

The carrying values of the above liabilities are assumed to approximate their fair values due to the nature of the liabilities.

It is the intention of the Company to close out all derivative financial instruments with negative fair value positions in 2017, therefore cash flows in respect of these derivative liabilities are included within 1 year in the maturity analysis above.

**(iv) Capital management**

The Company falls within the exclusion in Article 11 of EU Directive 2009/138/EC (Solvency II Directive). On the application of the Company in December 2015 the Prudential Regulation Authority made directions under section 138A of the Financial Services and Markets Act 2000 which last until 31 December 2020. The principal effects of the directions are that: the Company is not regulated as if subject to Solvency II; and the Company's Capital Resources requirement is zero.

However the Company maintains an efficient capital structure consistent with its risk profile and the market requirements of its business.

The Company's objectives in managing its capital are:

- to match the profile of its assets and liabilities, taking account of the risks inherent in the business;
- to maintain financial strength to support new business growth;
- to satisfy the requirements of its policyholders, regulators and rating agencies;
- to retain financial flexibility by maintaining strong liquidity and access to a range of capital markets;
- to allocate capital efficiently to support growth; and
- to manage exposures to movement in exchange rates.

As detailed in note 5(a) the Company considers not only traditional sources of capital funding but also reinsurance as an alternative source of capital.

**(v) Fair value estimation**

The company classifies financial instruments held at fair value in the statement of financial position into the following levels according to the definitions below. A fair value measurement is categorised in its entirety on the basis of the lowest level input that is significant to the fair value measurement.

Level 1: The unadjusted quoted price in an active market for identical assets or liabilities that the entity can access at the measurement date.

Level 2: Inputs other than quoted prices included within Level 1 that are observable (i.e. developed using market data) for the asset or liability, either directly or indirectly.

Level 3: Inputs are unobservable (i.e. for which market data is unavailable) for the asset or liability.

## Notes to the financial statements for the year ended 31 December 2016

The following tables show the Company's financial assets and financial liabilities measured at fair value:

<b>Financial assets as at 31 December 2016</b>	<b>Level 1 £000</b>	<b>Level 2 £000</b>	<b>Level 3 £000</b>	<b>Total £000</b>
Shares and other variable-yield securities and units in unit trusts	618,178	166,262	-	784,440
Debt securities and other fixed income securities	1,760,555	3,075,734	-	4,836,289
Loans	-	25,073	-	25,073
Deposits with credit institutions	10,751	587,206	-	597,957
Other (including derivative instruments)	2,127	13,756	-	15,883
	<u>2,391,611</u>	<u>3,868,031</u>	<u>-</u>	<u>6,259,642</u>

<b>Financial liabilities as at 31 December 2016</b>	<b>Level 1 £000</b>	<b>Level 2 £000</b>	<b>Level 3 £000</b>	<b>Total £000</b>
Deposits with credit institutions	(243)	-	-	(243)
Other (including derivative instruments)	(6,804)	(67,100)	-	(73,904)
	<u>(7,047)</u>	<u>(67,100)</u>	<u>-</u>	<u>(74,147)</u>

<b>Financial assets as at 31 December 2015</b>	<b>Level 1 £000</b>	<b>Level 2 £000</b>	<b>Level 3 £000</b>	<b>Total £000</b>
Shares and other variable-yield securities and units in unit trusts	555,685	126,236	-	681,921
Debt securities and other fixed income securities	2,045,376	2,563,469	-	4,608,845
Loans	-	24,218	-	24,218
Deposits with credit institutions	15,701	387,227	-	402,928
Other (including derivative instruments)	1,413	8,191	-	9,603
	<u>2,618,175</u>	<u>3,109,341</u>	<u>-</u>	<u>5,727,516</u>

<b>Financial liabilities as at 31 December 2015</b>	<b>Level 1 £000</b>	<b>Level 2 £000</b>	<b>Level 3 £000</b>	<b>Total £000</b>
Deposits with credit institutions	(244)	-	-	(244)
Other (including derivative instruments)	(45)	(82,707)	-	(82,752)
	<u>(289)</u>	<u>(82,707)</u>	<u>-</u>	<u>(82,996)</u>

The fair value of assets included in Level 1 are determined by the unadjusted quoted bid price in an active market as at the balance sheet date. At the year-end these assets comprised mainly developed market government bonds (including index-linked government bonds), listed equities and exchange traded derivatives.

If quoted prices in active markets are not available as defined in Level 1, the fair value of the asset can be determined using using a valuation technique with inputs that are observable (i.e. using market data), either directly or indirectly. Assets valued using such valuation techniques are categorised in Level 2. The Company has classified corporate bonds, emerging market government and semi-government bonds, asset backed securities, term loans and over the counter (OTC) derivatives within Level 2. The Company closely monitors the valuation of assets in markets that have become less liquid. Determining whether a market is active requires the exercise of judgement and is determined based upon the facts and circumstances of the market for the instrument being measured.

If the fair value of assets is estimated using a valuation technique where it is determined that any one or more significant input is not based on observable market data, those assets are classified as Level 3. The Company does not classify any of its assets as Level 3.

**Notes to the financial statements for the year ended 31 December 2016**

The 2015 fair value hierarchy classification of certain financial assets has been restated as a result of the adoption of the amendment by the FRC to the levelling definitions for fair value hierarchy disclosures. The restated assets include term loans where the inputs are observable using market data. Set out below are the changes in fair value hierarchy classification for the financial assets as at 31 December 2015.

	<u>Level 1</u> £000	<u>Level 2</u> £000	<u>Level 3</u> £000	<u>Total</u> £000
Financial assets at 31 December 2015 (pre-reclassification)	2,618,175	3,085,123	24,218	5,727,516
Loans	-	24,218	(24,218)	-
Financial assets at 31 December 2015 (post-reclassification)	<u>2,618,175</u>	<u>3,109,341</u>	<u>-</u>	<u>5,727,516</u>

**6 Gross Premiums Written and Outward Reinsurance Premiums**

Gross Premiums Written received by the Company in 2016 totalled £300,503k (2015: £306,926k). This all relates to the Company's principal activity which is reinsurance business conducted on a mutual basis from risks located in the United Kingdom.

Under the Company's Retrocession Agreement with HM Government, 50% (2015: 50%) of the value of Gross Premiums Written incepting during the year is payable as outward reinsurance premiums to HM Government. In 2016 this amounted to £150,255k (2015: £153,820k). An amount of further premium to HM Government is provided for in accordance with the Retrocession Agreement, being £99,447k in 2016 (2015: £33,511k).

Commercial retrocession has also been purchased, as described further in note 5(a) insurance risk. In 2016 this amount was £35,163k (2015: £33,299k).

**7 Net Operating Expenses**

**(a) Net Operating Expenses**

	<u>2016</u> £000	<u>2015</u> £000
Administrative expenses (including auditors' remuneration)	<u>10,536</u>	<u>8,707</u>

**(b) Auditors' remuneration**

	<u>2016</u> £000	<u>2015</u> £000
Fees payable to the Company's auditors for the audit of the Company's financial statements	72	75
Fees payable to the Company's auditors for other services:		
Taxation compliance services	127	120
Other assurance services	25	25
	<u>224</u>	<u>220</u>

The figures above are stated excluding VAT.

**Notes to the financial statements for the year ended 31 December 2016**

**8 Operating Lease Rentals**

	<u>2016</u> <u>£000</u>	<u>2015</u> <u>£000</u>
Operating lease rentals payable for the year:		
Land and buildings	188	144
Plant and machinery	4	4
	<u>192</u>	<u>148</u>

The Company had the following future minimum lease payments (excluding VAT) under non-cancellable operating leases for each of the following periods:

	<u>2016</u> <u>£000</u>	<u>2015</u> <u>£000</u>
<b>Payments due:</b>		
Not later than one year	520	148
Later than one year and not later than five years	1,761	82
Later than five years	366	-
	<u>2,647</u>	<u>230</u>

The Company entered into a new 10 year operating lease for office premises, with effect from 28th October 2016. There is a break clause after the 6th year. The current office is under lease until 17th July 2017.

**9 Employees and Directors**

The monthly average number of persons employed on a full time equivalent basis by the Company during the year was 21 (2015:16).

<b>Employees</b>	<u>2016</u> <u>£000</u>	<u>2015</u> <u>£000</u>
Staff costs for these persons were:		
Wages and salaries	4,591	4,093
Social security costs	604	541
Other pension costs	81	37
	<u>5,276</u>	<u>4,671</u>

<b>Directors</b>	<u>2016</u> <u>£000</u>	<u>2015</u> <u>£000</u>
The directors' emoluments were as follows:		
Aggregate emoluments	370	304
Sums paid to third parties for director services	87	62
	<u>457</u>	<u>366</u>

<b>Highest paid director</b>	<u>£000</u>	<u>£000</u>
The highest paid director's emoluments were as follows:		
Aggregate emoluments	<u>75</u>	<u>86</u>

**Key management compensation**

Key management includes the directors and members of senior management. The compensation paid or payable to key management for their services is shown below:

	<u>2016</u> <u>£000</u>	<u>2015</u> <u>£000</u>
Salaries and other short-term benefits	2,315	3,376
Long-term incentive plans	1,409	-
	<u>3,724</u>	<u>3,376</u>

The long-term incentive plan is awarded for the services performed in 2016 which will be paid out in 2019, 2020 and 2021 in three equal instalments. Where an individual leaves employment or a material risk event occurs payment may be reduced or forfeited.

Notes to the financial statements for the year ended 31 December 2016

10 Investment Return

	<u>2016</u> £000	<u>2015</u> £000
<b>Investment income</b>		
Income from financial assets at fair value through profit and loss	126,683	125,172
<b>Net losses on the realisation of investments</b>	(231,831)	(12,231)
<b>Net unrealised gains/(losses) on investments</b>	469,206	(157,012)
<b>Investment expenses and charges</b>		
Investment management and other charges	(6,280)	(5,970)
Interest payable on outwards reinsurance		
Less than one year	(3,772)	(3,982)
Greater than one year	(4,846)	(1,639)
Interest payable on outwards reinsurance - further premiums		
Greater than one year	(3,377)	(867)
	<u>(18,275)</u>	<u>(12,458)</u>
<b>Total investment return</b>	<u>345,783</u>	<u>(56,529)</u>

11 Tax on Profit on Ordinary Activities

	<u>2016</u> £000	<u>2015</u> £000
Tax on profit on ordinary activities comprised:		
United Kingdom Corporation Tax		
Current tax on income for the year at 20.00% (2015: 20.25%)	(23,572)	(3,987)
Adjustments in respect of prior years	41	(341)
<b>Total current tax</b>	<u>(23,531)</u>	<u>(4,328)</u>
Deferred tax - origination and reversal of timing differences at 20.00% (2015: 20.25%)	(30,105)	19,824
<b>Tax on profit on ordinary activities</b>	<u>(53,636)</u>	<u>15,496</u>

Factors affecting the tax charge for the year

The tax assessed for the year is different from the standard rate of UK Corporation Tax: 20.00% (2015: 20.25%). The differences are explained below:

	<u>2016</u> £000	<u>2015</u> £000
<b>Non-technical account</b>		
<b>Profit on ordinary activities before tax</b>	<u>351,973</u>	<u>85,036</u>
Corporation Tax at the standard UK rate of 20.00% (2015: 20.25%) on profit on ordinary activities	(70,395)	(17,220)
Adjustments for non-taxable items. Tax at 20.00% (2015: 20.25%) on:		
Technical income	1,238	28,667
Dividend income	3,300	2,975
Other investment expenses, capital allowances and bank charges	455	488
Investment gains/(losses) on equities	36,184	(21,674)
Investment gains on index-linked government bonds	5,646	2,777
Adjustments in respect of prior year	41	(341)
Deferred tax	(30,105)	19,824
<b>Tax on profit on ordinary activities</b>	<u>(53,636)</u>	<u>15,496</u>

## Notes to the financial statements for the year ended 31 December 2016

## 12 Other Financial Investments

Other financial investments comprised:	<u>2016</u> £000	<u>2015</u> £000
<b>Financial assets</b>		
Shares and other variable-yield securities and units in unit trusts	784,440	681,922
Debt securities and other fixed income securities	4,836,289	4,608,844
Loans	25,073	24,218
Deposits with credit institutions	597,957	402,928
Derivatives	15,883	9,603
	<u>6,259,642</u>	<u>5,727,516</u>
<b>Financial liabilities</b>		
Deposits with credit institutions	(243)	(244)
Derivatives	(73,904)	(82,752)
	<u>(74,147)</u>	<u>(82,996)</u>

All financial investments are accounted for at fair value with the movement in fair value passed through the Profit and Loss Account.

As at 31 December 2016 the purchase cost of shares and other variable-yield securities was £634,002k (2015: £713,196k), the purchase cost of debt securities and other fixed income securities was £4,484,595k (2015: £4,500,431k), the purchase cost of loans was £22,368k (2015: £23,805k), the purchase cost of deposits with credit institutions was £576,671k (2015: £397,427k) and the purchase cost of derivatives was £3,217k (2015: £795k).

The tables below show fair values of derivative contracts outstanding at the year end:

	<u>2016</u> £000	<u>2016</u> £000	<u>2015</u> £000	<u>2015</u> £000
	Fair value	Notional	Fair value	Notional
<b>Assets</b>				
Foreign exchange contracts	10,750	1,308,730	7,106	921,908
Futures contracts	1,912	516,551	1,334	388,211
Option contracts	241	17,451	79	27,870
Swap contracts	2,980	70,351	1,085	29,131
	<u>15,883</u>	<u>1,913,083</u>	<u>9,603</u>	<u>1,367,120</u>
	<u>2016</u> £000	<u>2016</u> £000	<u>2015</u> £000	<u>2015</u> £000
	Fair value	Notional	Fair value	Notional
<b>Liabilities</b>				
Foreign exchange contracts	(66,623)	3,810,626	(82,589)	3,338,897
Futures contracts	(6,778)	338,854	(36)	10,523
Option contracts	(37)	19,251	(10)	18,260
Swap contracts	(466)	13,944	(118)	23,677
	<u>(73,904)</u>	<u>4,182,675</u>	<u>(82,752)</u>	<u>3,391,357</u>

The movement through the Profit and Loss Account for derivatives was as follows: foreign exchange contracts produced a loss of £497,704k (2015: loss of £79,929k); futures contracts produced a loss of £22,223k (2015: loss of £4,255k); option contracts produced a loss of £828k (2015: profit of £666k) and swap contracts produced a profit of £74k (2015: profit of £12k).



## Notes to the financial statements for the year ended 31 December 2016

## 13 Tangible Assets

	<u>Computer and telephone equipment</u> £000	<u>Furniture and fixtures</u> £000	<u>Total</u> £000
<u>Book cost</u>			
At 1 January 2016	216	582	798
Additions	6	139	145
Disposals	(39)	-	(39)
<b>At 31 December 2016</b>	<b>183</b>	<b>721</b>	<b>904</b>
<u>Accumulated depreciation</u>			
At 1 January 2016	215	331	546
Charge for the year	4	128	132
Disposals	(39)	-	(39)
<b>At 31 December 2016</b>	<b>180</b>	<b>459</b>	<b>639</b>
<u>Net book value</u>			
<b>At 31 December 2016</b>	<b>3</b>	<b>262</b>	<b>265</b>
At 31 December 2015	1	251	252

The charge for depreciation for the year ended 31 December 2015 was £197k.

## 14 Cash at Bank and in Hand

	<u>2016</u> £000	<u>2015</u> £000
Cash at bank	8,167	2,064
Cash in investments	39,664	50,552
Cash at bank and in hand	<b>47,831</b>	<b>52,616</b>

The average interest rate earned by the Company on cash at bank and in hand was 0.09% (2015: 0.15%).

## 15 Debtors Arising Out of Reinsurance Operations

The Company has debtors arising out of reinsurance operations of £76,648k (2015: £75,820k) at the year end. The debtors balance comprises gross written premiums from Members corresponding to the fourth quarter of the year. The balance has since been received in full.

## 16 Other Debtors

	<u>2016</u> £000	<u>2015</u> £000
Other debtors comprised:		
Current taxation	-	1,932
Investment debtors	4,045	5,842
Other debtors	197	136
	<b>4,242</b>	<b>7,910</b>

Notes to the financial statements for the year ended 31 December 2016

17 Provision for Unearned Premiums

The reconciliation of the opening and closing unearned premiums provision is as follows:

	<u>2016</u> <u>£000</u>	<u>Gross</u> <u>2015</u> <u>£000</u>	<u>Reinsurers' share</u> <u>2016</u> <u>£000</u>	<u>2015</u> <u>£000</u>
At 1 January	147,779	147,023	79,273	14,702
Increase in provision	995	756	798	64,571
At 31 December	<u>148,774</u>	<u>147,779</u>	<u>80,071</u>	<u>79,273</u>

18 Provisions for Other Risks

	<u>Deferred</u> <u>tax</u> <u>£000</u>	<u>Outward</u> <u>reinsurance</u> <u>premiums</u> <u>£000</u>	<u>Total</u> <u>£000</u>
Provisions for other risks comprised:			
At 1 January 2016	-	224,925	224,925
Utilised in the year	-	(33,480)	(33,480)
Interest expense on outward reinsurance	-	11,995	11,995
Profit and Loss Account charge	30,105	249,702	279,807
At 31 December 2016	<u>30,105</u>	<u>453,142</u>	<u>483,247</u>

There are no unused tax losses or unused tax credits.

19 Creditors Arising Out of Reinsurance Operations

The Company has creditors arising out of reinsurance operations which are made up as follows:

	<u>2016</u> <u>£000</u>	<u>2015</u> <u>£000</u>
Retrocession payable to HM Government on 31 March 2017 (2015: 31 March 2016)	33,479	32,631
Member refunds	6	76
	<u>33,485</u>	<u>32,707</u>

Retrocession outstanding at the year end is in respect of 2014 (2015: in respect of 2013) and prior underwriting periods in line with payment terms outlined in the agreement with HM Government.

20 Other Creditors Including Tax and Social Security

	<u>2016</u> <u>£000</u>	<u>2015</u> <u>£000</u>
Other creditors comprised:		
Investment creditors	9,508	3,650
Current taxation	2,658	-
Other creditors	2,377	1,394
	<u>14,543</u>	<u>5,044</u>

Notes to the financial statements for the year ended 31 December 2016

**21 Reconciliation of Operating Profit to Net Cash Inflow from Operating Activities**

	<u>2016</u> £000	<u>2015</u> £000
Profit for the financial year transferred to Profit and Loss Account reserves	298,337	100,532
Adjustments:		
Tax on profit on ordinary activities	53,636	(15,496)
Net unrealised (gains)/losses on investments	(469,206)	157,012
Net realised losses on investments	231,831	12,231
Income from financial assets at fair value through profit and loss	(126,683)	(125,172)
Depreciation	132	197
Interest expense	11,995	6,488
Increase in reinsurers' share of technical provisions	(798)	(64,571)
Decrease/(increase) in debtors excluding tax receivable	908	(14,670)
Increase in other prepayments	(227)	(71)
Decrease in technical provisions	(2,560)	(5,884)
Increase in provision for other risks excluding deferred tax and interest payable	218,663	160,321
Increase in creditors, accruals and deferred income excluding interest and tax	7,978	1,479
<b>Net cash inflow from operating activities</b>	<u><u>224,006</u></u>	<u><u>212,396</u></u>

**22 Movements in the Profit and Loss Account**

	<u>2016</u> £000	<u>2015</u> £000
Profit and Loss Account at 1 January	5,481,086	5,380,554
Profit for the financial year	298,337	100,532
Dividend paid	(33,511)	-
<b>Profit and Loss Account at 31 December</b>	<u><u>5,745,912</u></u>	<u><u>5,481,086</u></u>

**23 Distribution to Members**

At an Extraordinary General Meeting held on 21 November 2014, amendments to the Retrocession Agreement between Pool Re and HM Government were approved by Members. The new terms, which took effect from 1 January 2015, include the provision for the Company to pay a dividend to Members in the event that it has earned a profit in the year, equal to 25% of the profit after tax, before Further Premium payable to HM Government.

The Board declared such a dividend on 28 June 2016 in respect of its 2015 results. The amount of the dividend paid was £33,511k.

**24 Floating Charge over the Company's Assets**

On 7 September 1993 and on 2 February 2017 the Company executed debenture deeds granting HM Government floating charges over the Company's assets. The deeds and associated charges relate respectively to the Retrocession Agreements applicable up to and including 31 December 2014 and from 1 January 2015. The terms of the charges restrict the Company from creating further charges without the consent of HM Government. The floating charges crystallise and take effect as a fixed charge in the event, inter alia, of default by the Company in meeting certain of its obligations to HM Government under the relevant Retrocession Agreement and upon termination of that Agreement.

**Notes to the financial statements for the year ended 31 December 2016**

**25 Related Party Transactions**

In 2016 the Company purchased commercial retrocession in the ordinary course of business through Guy Carpenter & Company Limited totalling £35,163k (2015: £33,299k). There was no outstanding balance at 31 December 2016. Peter Box, a Director of the Company, is a Director of Marsh Limited. Both Guy Carpenter & Company Limited and Marsh Limited are members of the Marsh & McLennan Companies, Inc. group.

In 2016 the Company purchased investment advice in the ordinary course of business from Mercer Limited totalling £88k (2015: £96k). At 31 December 2016 there was an outstanding balance of £9k. Peter Box, a Director of the Company, is a Director of Marsh Limited. Both Mercer Limited and Marsh Limited are members of the Marsh & McLennan Companies, Inc. group.

In 2016 the Company purchased public relations services in the ordinary course of business from MHP Communications totalling £110k (2015: £56k). At 31 December 2016 there was an outstanding balance of £10k. Sir Brian Bender, a Director of the Company, was Chair of the Advisory Board of MHP Communications until June 2016.

In 2016 the Company purchased legal services in the ordinary course of business from Hogan Lovells International LLP totalling £93k (2015: £146k). There was no outstanding balance at 31 December 2016. Christian Wells, General Counsel and Company Secretary of the Company, is a Consultant at Hogan Lovells International LLP.

Key management personnel compensation is disclosed in total in note 9.

**26 Subsequent events**

At the date of the approval of the financial statements there are no known subsequent events.

**Members' Profile  
as at 31 December 2016**

	<u>Number of Members</u>	<u>Percentage of Members</u>	<u>Number of Votes</u>	<u>Percentage of Votes</u>
<b>Analysis by Jurisdiction</b>				
Austria	1	0.5%	1	0.0%
Bermuda	3	1.5%	0	0.0%
France	5	2.6%	1	0.0%
Germany	2	1.0%	5	0.0%
Gibraltar	3	1.5%	0	0.2%
Guernsey	27	14.0%	38	1.3%
Iceland	1	0.5%	0	0.0%
Isle of Man	11	5.7%	40	1.3%
Italy	1	0.5%	1	0.0%
Liechtenstein	1	0.5%	1	0.0%
Malaysia	1	0.5%	0	0.0%
Malta	3	1.5%	0	0.0%
Republic of Ireland	14	7.2%	13	0.4%
Spain	1	0.5%	3	0.1%
United Kingdom	80	41.3%	2,822	92.3%
United States of America	4	2.1%	7	0.2%
	<u>158</u>	<u>81.4%</u>	<u>2,932</u>	<u>95.8%</u>
Active Underwriters of Lloyd's Syndicates	36	18.6%	128	4.2%
	<u>194</u>	<u>100.0%</u>	<u>3,060</u>	<u>100.0%</u>
<b>Analysis by Number of Votes</b>				
0	68	35.4%	0	0.0%
1-25	107	54.9%	371	12.1%
26-50	6	3.1%	231	7.6%
51-100	6	3.1%	417	13.6%
101-150	2	1.0%	231	7.6%
151-200	0	0.0%	0	0.0%
201-250	2	1.0%	431	14.1%
251-300	0	0.0%	0	0.0%
301-350	1	0.5%	340	11.1%
351-400	0	0.0%	0	0.0%
401-450	1	0.5%	432	14.1%
451-500	0	0.0%	0	0.0%
501-550	0	0.0%	0	0.0%
551-600	0	0.0%	0	0.0%
601-650	1	0.5%	607	19.8%
	<u>194</u>	<u>100.0%</u>	<u>3,060</u>	<u>100.0%</u>

**Note**

Under Article 33 of the Articles of Association, for the first calendar year of membership, a Member shall have one vote. Thereafter, under the provisions of Article 31, a Member has one vote for each £100,000 of premium or part thereof for reinsurance placed with the Company in the calendar year prior to the poll. Under Article 32, if data for the prior calendar year is not available when the votes are to be cast, data from the previous prior calendar year may be used.