

**ADVENT CAPITAL (No.3) LIMITED**

**ANNUAL REPORT AND FINANCIAL STATEMENTS**

**FOR THE YEAR ENDED**

**31 DECEMBER 2016**

TUESDAY



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## **ADVENT CAPITAL (No.3) LIMITED**

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**ADVENT CAPITAL (No.3) LIMITED**

**DIRECTORS AND ADVISORS**

**Directors**

T J Ambridge  
I M Hewitt (appointed as a director on 19 January 2016)  
P J Green (resigned as a director on 19 January 2016)

**Company Secretary**

N M Ewing ACII

**Registered Office**

2nd Floor  
2 Minster Court  
London EC3R 7BB

**Independent Auditors**

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

**Solicitors**

Clyde & Co LLP  
The St Botolph Building  
138 Houndsditch  
London  
EC3A 7AR

**Company Registration Number**

5528808

## **ADVENT CAPITAL (No.3) LIMITED**

### **STRATEGIC REPORT**

*All amounts are in millions of United States dollars, unless otherwise stated*

The Directors present their Strategic Report for the year ended 31 December 2016.

#### **Business Review**

Advent Capital (No.3) Limited (the Company), a company incorporated in the United Kingdom, is the Corporate Member underwriting at Lloyd's supporting 100% of Syndicate 780's capacity.

#### **Strategic Report**

The key disclosures required by the Strategic Report have been considered in the sections below, being results of the business for the calendar year, future outlook and principal risks and uncertainties.

#### **Result for the Calendar Year**

For the year ended 31 December 2016, the Company had a profit on ordinary activities before taxation of \$13.0 (2015: loss of \$37.7).

The Company seeks to achieve consistent underwriting profitability through the exercise of disciplined underwriting and risk management practises, high degrees of service and professionalism attributable to its claims and other supporting operations, prudent technical reserve standards and valued long standing trading relationships.

Gross premiums written increased by 7.2% to \$257.8 in 2016 (2015 - \$240.5), due to growth in the Accident & Health (A&H) and the Property Binders classes of business, partially offset by the effects of the competitive underwriting environment across many classes, particularly Property and Energy Insurance. For the year ended 31 December 2016, the portfolio mix was 82% insurance and 18% reinsurance (2015: 76% and 24% respectively).

Net premiums written increased by 1.3% to \$177.0 in 2016 (2015 - \$174.8), consistent with gross premiums written except that the A&H class of business has quota share reinsurance of up to 75% on business sourced with Fairmont with \$51.5 of premiums written and \$27.0 of losses ceded (2015: \$34.2 and \$11.9, respectively).

The Company restructured the timing of its outwards excess of loss reinsurance purchase in 2016, with the majority of purchases commencing at 1 April, as opposed to 1 January previously. The Company ceded premiums of \$16.8 (2015: \$17.8) to its excess of loss programme.

Net premiums earned increased by 15.2% to \$183.7 in 2016 (2015 - \$157.9), reflecting the maturing of the Company's specialty insurance business.

The lower expense ratio results from the effect of the weaker £/\$ exchange rate on a stable expense base in sterling terms on higher net earned premiums.

#### **2017 Business Plans and Outlook**

Syndicate 780's 2017 business plan and SCR have been approved by Lloyd's, with gross premiums of \$293.4. Competitive market conditions continue to prevail across all classes of business, with surplus capacity putting pressure on rates, terms and conditions. In addition, broker portfolio placements and greater cedent risk retention has put pressure on signings. The Company views the Fairfax distribution network as a key differentiator in developing new business.

#### **Internal Control and Risk Management**

##### **Overview**

The Board of Directors ("Board") is responsible, working with the Advent Capital (Holdings) LTD group of companies ("ACH"), for the oversight of the Company's systems of internal control, for reviewing their effectiveness at least annually and for reporting on the effectiveness of controls in the Company's Annual Report and Accounts. Executive Management is responsible for the implementation and satisfactory maintenance of systems of internal controls over financial reporting and for compliance with laws and regulations.

All employees are responsible for internal control and are informed of their role through detailed job descriptions, policies, procedures manuals and communications from Business Unit Leaders and the Board.

The Company's systems of internal control consist of a number of interrelated components as outlined below:

## STRATEGIC REPORT (continued)

### Control Environment

The control environment sets the tone of the business influencing the control consciousness of its directors and employees, sometimes referred to as the “tone at the top”. It provides structure and discipline for the other four components, incorporating factors such as integrity, ethical values, management’s philosophy and operating style; assignment of authority and responsibility; employee competence; organisational structure; and the attention and direction provided by the Board.

The control environment is communicated to employees through the following key policies approved by the Board:

- Corporate objectives and risk appetite
- Code of Business Conduct and Ethics
- Whistle Blowing
- Anti-Bribery and Corruption, Confidentiality and Trading Responsibilities regarding Fairfax
- Anti-money laundering and financial crime
- Documented policies and procedures for each Business Unit

As a small organisation, the Company’s culture is hands-on with extensive interaction between directors, Business Unit Leaders and employees and one which takes pride in maintaining strong underwriting disciplines throughout the insurance cycle while acknowledging the potential volatility in short term results arising from catastrophe events.

### Risk Assessment

The Company faces a variety of risks from both internal and external sources that require identification, assessment and management. Risk management is the process that enables a business to:

- Identify and understand the risks that it faces in the pursuit of its business objectives;
- Assess the risks against risk appetite;
- Where possible and commercially desirable, reduce the probability and impact of those risks;
- Regularly review, monitor and report on those risks in order to take informed actions; and
- Ensure that any new risks, or changes to existing risks, are captured and assessed.

As the environment in which the Company is operating is constantly changing, the risk assessment process needs to be dynamic and updated on an on-going basis.

The key risks, as assessed by the Company, are set out below:

- **Insurance risk:**
  - **Underwriting and risk selection:** The Company is exposed to risk when underwriters select and price insurance and reinsurance business as there is uncertainty over the ultimate loss ratios.
  - **Extreme losses:** Insurance costs are not fixed and known at the time a policy is issued, so claims can significantly exceed premiums received in any period. Although the frequency and severity of claims may have been priced accurately, in extreme circumstances, claims may be sufficiently large to threaten the Company’s capital base.
  - **Reserving:** The Company has a provision on its balance sheet for the estimated ultimate cost of claims. Some of these claims are long tailed in nature and as such, they are susceptible to adverse development (e.g. due to latent exposures, legal reform and unforeseen deterioration of known losses).
- **Other financial risks:**
  - **Credit risk:** The Company is exposed to the risk that a counterparty will be unable to pay amounts in full when due. The Company is exposed to credit risk through reinsurance recoverables and amounts due from intermediaries and policyholders. There remains an increased risk of counterparty failure in a challenging economic climate.
  - **Market risk:**
    - **Matching** – Mismatches in the duration of the Company’s assets and liabilities to movements in interest rates may lead to an increase in capital requirements while a mismatch in assets and liabilities denominated in foreign currencies may lead to losses from changes in exchange rates.
    - **Asset** – The Company’s investments (comprising individual holdings in sovereign and corporate fixed interest securities as well as equities, derivatives, real estate and cash) are also exposed to the risk of default and/or fluctuations in market prices.
    - **Liquidity risk** – The Company may not have cash available to pay obligations when due at a reasonable cost, particularly for major catastrophe events where it has to post US situs funds on gross incurred claims or where it has to pay gross claims before collecting the related reinsurance.
- **Operational risk:**
  - The Company is exposed to a range of operational risks, some of which could have a direct financial impact such as:

STRATEGIC REPORT (continued)

- inaccurate **management information** (e.g. through staff error, inadequate processes or loss of IT systems) causing inadequate pricing, reserving or exposure management;
    - loss of office **facilities** (though fire, flood, terrorism, etc.);
    - **outsourcing** issues; and
    - **fraud**.
  - Other operational risks may not have direct financial losses, but may be equally damaging to the Company's business model if not managed effectively. These include:
    - **Reputational:** Advent's business model relies on the maintenance of its good reputation. For example, Advent's ability to attract and retain staff or business from brokers will be undermined if it suffers reputational damage from the actions of the Company itself or indirectly due to the actions of employees.
    - **Conduct:** Advent has a duty to ensure that the process and outcome from doing business with the Company is fair for all policyholders.
    - **Regulatory:** Advent Underwriting Limited, our primary operational subsidiary, is regulated by the PRA, FCA and Lloyd's of London (Lloyd's). The Company is at risk of censure, fine or restriction of business if it fails to run the business in compliance with the applicable rules and regulations.
    - **Cultural:** There is a risk that Advent fails to ensure it has a culture that promotes an effective and efficient working environment which encourages teamwork from all members of staff.
    - **Political changes:** There is a risk that Advent's business model is impacted by changes to the economic landscape, for example, changes to the tax regime or the legal framework.
- **Other Risks:**
    - **Group** – The risk of the Fairfax group being unable to support Advent, particularly in the provision of new capital if it is required.
    - **Strategic** – Advent faces the risk of loss through the setting of an inappropriate strategy or the ineffective execution of an appropriate strategy.
    - **Capital** – Advent has to ensure that it has sufficient capital from a regulatory perspective in order to trade at Lloyd's within the PRA's regulatory regime.

Ownership of risks and controls within the Company is clearly defined. The Risk Function coordinates an assessment of all risks through a quarterly risk review, carried out in line with policies and procedures, to ensure that risks remain relevant and up-to-date.

All risks have a risk appetite recommended by the Director of Risk & Compliance to the Board for its approval. When any risk falls outside the Company's risk appetite, action plans are agreed, implemented and monitored. Risk mitigation actions have clearly defined owners and implementation timescales.

The Company's risk appetite for extreme losses, its major Insurance risk, is to limit the pre-tax cost of a single event catastrophe loss, after reinsurance recoveries and reinstatement premiums, to \$35.

This report has been prepared in accordance with the special provisions relating to small companies within Part 15 of the Companies Act 2006.

**Control Activities**

Control activities are the policies and procedures that are set by Executive Management to manage risk and support the delivery of the Company's objectives.

The Company maintains and updates policies and procedures addressing all key areas of the business.

**Information, Communication and Key Performance Indicators**

Appropriate information must be identified, captured and communicated in a form and timeframe that enables directors and employees to carry out their responsibilities. The Company has an established management information system for the production of operational, financial and compliance reports which allow the Executive Management and the Board to run and control the business.

The Company has established corporate objectives and risk appetite. The key performance data required for management and control purposes has been identified as the combined ratio, adequacy of reserves, exposure to catastrophe losses on a gross and net basis and performance against the approved business plan. Management reports are produced monthly for Executive Management and reported to the Board quarterly. Decision making is made at the appropriate level, within pre-agreed parameters, and communicated throughout the Company as required.

The Company maintains pro-active channels of communication with all key stakeholders including existing and prospective clients, staff, brokers, reinsurers, the shareholder, and regulators.

**STRATEGIC REPORT (continued)**

**Monitoring**

Internal control systems need to be monitored to assess the quality of the system over time. The Company achieves this through a combination of day-to-day operational monitoring conducted by management, such as the review of exception reports, together with a comprehensive risk based internal audit programme.

The audit programme is risk focussed with the majority of the activity centred upon those areas which are considered to generate the largest risks namely underwriting, reinsurance and claims.

The Company believes it has implemented an effective system of internal control.

**Key Performance Indicators (KPIs)**

The Directors of Advent manage the Group's operations at a syndicate level, rather than via the individual corporate member. For this reason, the Company's Directors believe that analysis using KPIs for the Company is not necessary or appropriate for an understanding of the development, performance or position of the Company. The development, performance and position of Advent, which includes the Company, is discussed in the financial review of Advent's Annual Report and Financial Statements, which does not form part of these Financial Statements.

Approved by the Board of Directors and signed on its behalf by:



N M Ewing ACII  
Company Secretary  
17 February 2017

## REPORT OF THE DIRECTORS

The Directors present their report and the audited financial statements of the Company for the year ended 31 December 2016.

### Future Outlook

The future outlook of the Company is discussed in the Strategic Report.

### Dividends

The directors do not propose the payment of a dividend (2015: \$Nil).

### Directors

The names of the current directors are listed on page 2.

### Statement of Directors' Responsibilities

The directors are responsible for preparing the Annual Report and 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 shareholders 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.

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

### Statement of disclosure of information to auditors

Each of the persons who is a director at the date of this report confirms that:

1) so far as each of them is aware, there is no information relevant to the audit of the Company's financial statements for the year ended 31 December 2016 of which the auditors are unaware; and

2) the director has taken all steps that he ought to have taken in his duty as a director in order to make himself aware of any relevant audit information and to establish that the Company's auditors are aware of that information.



**ADVENT CAPITAL (No.3) LIMITED**

**REPORT OF THE DIRECTORS (continued)**

**Independent auditors**

The auditors, PricewaterhouseCoopers LLP, have indicated their willingness to continue in office and a resolution concerning their re-appointment will be proposed at the Annual General Meeting.

Approved by the Board and signed on its behalf by:



N M Ewing ACI  
Company Secretary  
17 February 2017

## ***Independent auditors' report to the members of Advent Capital (No. 3) Limited***

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

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#### **Our opinion**

In our opinion, Advent Capital (No.3) 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 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 and Financial Statements (the "Annual Report"), comprise:

- the Statement of Financial Position as at 31 December 2016;
- the Statement of Comprehensive Income 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.

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

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

- the information given in the Strategic Report and the Report of the Directors for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the Strategic Report and the Report of the Directors 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 Report of the Directors. We have nothing to report in this respect.

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### **Other matters on which we are required to report by exception**

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#### **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.

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#### **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.

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## Responsibilities for the financial statements and the audit

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### Our responsibilities and those of the directors

As explained more fully in the Statement of Directors' Responsibilities set out on page 7, 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.

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### 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 Report of the Directors, we consider whether those reports include the disclosures required by applicable legal requirements.



Mark Bolton (Senior Statutory Auditor)  
for and on behalf of PricewaterhouseCoopers LLP  
Chartered Accountants and Statutory Auditors  
London  
February 2017

**ADVENT CAPITAL (No.3) LIMITED**
**STATEMENT OF COMPREHENSIVE INCOME – TECHNICAL ACCOUNT**

For the year ended 31 December 2016

	Note	2016 \$	2015 \$
<b>Net premiums earned</b>			
Gross premiums written	6	257.8	240.5
Outward reinsurance premiums		(80.8)	(65.7)
Net premiums written		177.0	174.8
Change in the provision for unearned premiums			
- gross amount		1.8	(30.3)
- reinsurers' share		4.9	13.4
Change in the net provision for unearned premiums		6.7	(16.9)
<b>Net premiums earned</b>		<b>183.7</b>	<b>157.9</b>
Allocated investment return transferred from the non-technical account		17.8	(2.4)
<b>Total technical income</b>		<b>201.5</b>	<b>155.5</b>
<b>Claims incurred, net of reinsurance</b>			
Claims paid			
- gross amount		(163.9)	(117.3)
- reinsurers' share		42.2	23.2
Net claims paid		(121.7)	(94.1)
Change in the provision for claims			
gross amount		25.3	16.5
reinsurers' share		(11.1)	(7.8)
Change in the net provision for claims		14.2	8.7
<b>Claims incurred, net of reinsurance</b>		<b>(107.5)</b>	<b>(85.4)</b>
Net operating expenses	10	(76.9)	(76.7)
<b>Total technical charges</b>		<b>(184.4)</b>	<b>(162.1)</b>
<b>Balance on the technical account for general business</b>		<b>17.1</b>	<b>(6.6)</b>

The Notes on pages 15 to 36 are an integral part of these financial statements.

# ADVENT CAPITAL (No.3) LIMITED

## STATEMENT OF COMPREHENSIVE INCOME NON-TECHNICAL ACCOUNT For the year ended 31 December 2016

	Note	2016 \$	2015 \$
<b>Balance on the technical account for general business</b>		<b>17.1</b>	<b>(6.6)</b>
Investment income	9	1.4	13.3
Unrealised gains on investments	9	22.3	3.6
Unrealised losses on investments	9	(22.0)	(54.2)
Investment management expenses	9	(1.4)	(1.5)
Allocated investment return transferred to the general business technical account		(17.8)	2.4
Other income and charges		13.4	5.3
<b>Profit (loss) before tax</b>		<b>13.0</b>	<b>(37.7)</b>
Tax provision	12	(3.7)	9.0
<b>Profit (loss) for the year</b>		<b>9.3</b>	<b>(28.7)</b>
Accumulated losses at 1 January		(129.0)	(100.3)
<b>Accumulated losses at 31 December</b>		<b>(119.7)</b>	<b>(129.0)</b>

The income and expenses all relate to continuing operations.

There are no material differences between the profit (loss) on ordinary activities before taxation and the profit (loss) for the year stated above and their historical cost equivalents.

The Notes on pages 15 to 36 are an integral part of these financial statements.

**ADVENT CAPITAL (No.3) LIMITED**
**STATEMENT OF FINANCIAL POSITION: ASSETS**
**As at 31 December 2016**

	Note	2016 \$	2015 \$
<b>Assets</b>			
Intangible assets	13	-	0.4
<b>Financial investments</b>		<b>472.1</b>	<b>407.9</b>
<b>Reinsurers' share of technical provisions</b>			
Provision for unearned premiums		28.5	23.6
Claims outstanding		45.3	59.3
		<b>73.8</b>	<b>82.9</b>
<b>Debtors</b>			
Debtors arising out of direct insurance operations		49.7	59.1
Debtors arising out of reinsurance operations		36.4	38.9
Deferred taxation	12	5.2	7.6
Current taxation		-	0.5
Other assets		8.2	6.7
		<b>99.5</b>	<b>112.8</b>
<b>Cash and equivalents</b>		<b>17.6</b>	<b>23.8</b>
<b>Prepayments and accrued income</b>			
Accrued interest		1.0	1.3
Deferred acquisition costs		27.0	28.6
<b>Total Assets</b>		<b>691.0</b>	<b>657.7</b>

The Notes on pages 15 to 36 are an integral part of these financial statements.

**ADVENT CAPITAL (No.3) LIMITED**

**STATEMENT OF FINANCIAL POSITION: LIABILITIES**

**As at 31 December 2016**

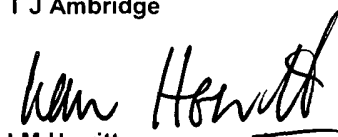
	Note	2016 \$	2015 \$
<b>Liabilities and reserves</b>			
<b>Capital and reserves</b>			
Called up share capital	14	0.1	0.1
Share premium account		131.4	131.4
Accumulated losses		(119.7)	(129.0)
<b>Total shareholder's funds</b>		<b>11.8</b>	<b>2.5</b>
<b>Technical provisions</b>			
Provision for unearned premiums		105.1	109.3
Claims outstanding		313.8	348.5
		<b>418.9</b>	<b>457.8</b>
<b>Creditors</b>			
Creditors arising out of (re)insurance operations		27.8	39.9
Amounts owed to group undertakings		220.4	148.2
Other creditors		3.7	1.1
		<b>251.9</b>	<b>189.2</b>
<b>Accruals and deferred income</b>		<b>8.4</b>	<b>8.2</b>
<b>Total liabilities</b>		<b>691.0</b>	<b>657.7</b>

The financial statements on pages 11 to 36 were approved by the Board of Directors on 17 February 2017 and signed on its behalf by:



T J Ambridge

Director



I M Hewitt

Director

Company Registration Number: 5528808

The Notes on pages 15 to 36 are an integral part of these financial statements.

## **ADVENT CAPITAL (No.3) LIMITED**

### **NOTES TO THE FINANCIAL STATEMENTS**

#### **1. General Information**

The financial statements of the Syndicate were approved by the Board of Advent Capital (No. 3) Limited on 17 February 2017.

The Company participates in insurance business as an underwriting member at Lloyd's. The assets and liabilities arising as a result of the underwriting activities are held under various Lloyd's trust deeds for the benefit of policyholders.

#### **2. Statement of compliance**

The individual financial statements of the Company 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 and the Companies Act 2006, under the provision of The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (SI2008/410). The Company has also adopted Technical Release 1/99 "Accounting by Lloyd's Corporate Capital Vehicles" issued by the Institute of Chartered Accountants in England and Wales.

#### **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. The Company has adopted FRS 102 and FRS 103 in these financial statements.

##### **(a) Basis of Preparation**

These financial statements are prepared on a going concern basis, under the historical cost convention.

The preparation of financial statements in conformity with FRS 102 requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Company's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the financial statements are disclosed in note 4.

##### **(b) Going concern**

The Company meets its day-to-day working capital requirements through the underwriting activities of Syndicate 780. Competitive market conditions continue to prevail across the insurance market with surplus capacity putting pressure on rates, terms and conditions. The Company's forecasts and projections, taking account of reasonably possible changes in trading performance, show that the Company should be able to operate and have the resources available to meet members' and Lloyd's capital requirements. After making enquiries, the directors have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future. The Company therefore continues to adopt the going concern basis in preparing its financial statements.

##### **(c) Exemptions for qualifying entities under FRS 102**

The Company has taken advantage of the exemption, under FRS 102 paragraph 1.12 (b), from preparing a statement of cash flows, on the basis that it is a qualifying entity and its parent Company, Advent Capital (Holdings) LTD (ACH), includes the Company's cash flows in its own consolidated financial statements.

##### **(d) Foreign currency**

###### **(i) Functional and presentation currency**

The Company's functional and presentational currency is US dollars.

###### **(ii) Transactions and balances**

Foreign currency transactions are translated into the functional currency using an average rate of exchange for the year. At each period end foreign currency monetary and non-monetary items are translated using the closing rate. Foreign exchange gains and losses resulting from the settlement of transactions and from the translation at period-end exchange rates of monetary and non-monetary assets and liabilities denominated in foreign currencies are recognised in the profit and loss account.

Foreign exchange gains and losses are presented in the income statement within "Net operating expenses" in the Balance on the technical account for general business.

Foreign exchange differences on non-syndicate transactions are reported in other charges in the non-technical account.



**NOTES TO THE FINANCIAL STATEMENTS (Continued)**

**3. Summary of significant accounting policies (continued)**

**(d) Foreign currency (continued)**

The Company uses forward exchange trades contracts to mitigate the exchange risk associated with claims in currencies other than its principle settlement currencies and to manage its currency balance sheet. Gains or losses are recorded within profit on exchange. The fair value of the forward exchange contracts is determined by reference to quoted period end exchange rates.

**(e) General insurance business**

The results for general insurance business written are determined on an annual basis whereby the incurred cost of claims, commission and related expenses are charged against the earned proportion of premiums, net of reinsurance, as follows:

- i) Premiums written relate to business incepted during the year, together with any differences 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, less an allowance for cancellations. Premiums are shown net of premium taxes and other levies on premiums.

Premiums are accreted to the income statement on a pro-rata basis over the term of the related policy, except for those contracts where the period of risk differs significantly from the contract period. In these cases, premiums are recognised over the period of risk in proportion to the amount of insurance protection provided.

- ii) Unearned premiums represent the proportion of premiums written that relate to unexpired terms of policies in force at the balance sheet date. The unearned premium reserve is translated at closing rates of exchange.
- iii) Acquisition costs, which represent commission and other related expenses, are allocated over the period in which the related premiums are earned.
- iv) Reinsurance premium costs of "losses occurring during" policies are charged over the period for which coverage is provided. Other reinsurance premium costs are deferred over the period in which the premiums relating to business written are earned.
- v) 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 (IBNR) and related expenses, together with any other adjustments to claims from previous years. Where applicable, deductions are made for salvage and other recoveries.
- vi) Claims outstanding represent the ultimate cost of settling all claims (including direct and indirect claims settlement costs) arising from events which have occurred up to the balance sheet date, including provision for IBNR, less any amounts paid in respect of those claims. Claims outstanding are reduced by anticipated salvage and other recoveries.
- vii) Provision is made at the year-end for the estimated costs of claims incurred but not settled at the balance sheet date, including the cost of IBNR to the Company. The estimated cost of claims includes expenses to be incurred in settling claims and a deduction for the value of salvage and other recoveries. 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.
- viii) Reinsurance assets include amounts recoverable from reinsurance companies for paid and unpaid losses and loss adjustment expenses, and ceded unearned premiums. Amounts receivable from reinsurers are calculated with reference to the claims liability associated with the reinsured risks. Any impairment to a reinsurance asset is immediately recognised in the Income Statement.

**(f) Investment Return**

Investment return comprises all investment income, realised investment gains and losses and movements in unrealised gains and losses, net of investment expenses, charges and interest.

Dividends are recorded on the date on which the shares are quoted ex-dividend. Interest income is recognized using the effective interest rate method.

**NOTES TO THE FINANCIAL STATEMENTS (Continued)**

**3. Summary of significant accounting policies (continued)**

**(f) Investment Return (continued)**

Realised gains and losses on investments carried at current value are calculated as the difference between net sales proceeds and purchase price. Movements in unrealised gains and losses on investment represent the difference between the valuation at the balance sheet date and their purchase price or, if they have been previously valued, their valuation at the last balance sheet date, together with the reversal of unrealised gains and losses recognised in earlier accounting periods in respect of investment disposals in the current period.

Investment return is initially recorded in the non-technical account. A transfer is made from the non-technical account to the technical account of the investment return on investments supporting the insurance technical provisions and related shareholder's funds.

**(g) Taxation**

Taxation expense for the year comprises current and deferred tax recognised in the reporting period. Tax is recognised in the income statement.

*Current or deferred tax liabilities are not discounted.*

*(i) Current tax*

Current tax is the amount of income tax payable in respect of the taxable profit for the current or prior years. Tax is calculated on the basis of tax rates and laws that have been enacted or substantively enacted by the period end.

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

*(ii) Deferred tax*

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

Deferred tax is recognised on all timing differences at the reporting date except for certain exceptions. Unrelieved tax losses and other deferred tax assets are only recognised when it is probable that they will be recovered against the reversal of deferred tax liabilities or other future taxable profits.

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

**(h) Intangible assets**

Costs incurred by the Company in the Lloyd's auctions to acquire rights to participate on the Syndicate's underwriting years are included within intangible fixed assets and amortised over a fifteen year period from the start of the underwriting year of account (YOA) for which the costs are incurred.

**(i) Impairment of non-financial assets**

At each balance sheet date non-financial assets not carried at fair value are assessed 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.

The recoverable amount of the asset is the higher of the fair value less costs to sell and value in use. Value in use is defined as the present value of the future pre-tax and interest cash flows obtainable as a result of the asset's continued use. The pre-tax and interest cash flows are discounted using a pre-tax discount rate that represents the current market risk-free rate and the risks inherent in the asset.

If the recoverable amount of the asset is estimated to be lower than the carrying amount, the carrying amount is reduced to its recoverable amount. An impairment loss is recognised in the income statement, unless the asset has been revalued when the amount is recognised in other comprehensive income to the extent of any previously recognised revaluation. Thereafter any excess is recognised in income.

If an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, but only to the extent that the revised carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised in prior periods. A reversal of an impairment loss is recognised in the income statement.

**NOTES TO THE FINANCIAL STATEMENTS (Continued)**

**3. Summary of significant accounting policies (continued)**

**(j) Cash and cash equivalents**

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

**(k) Financial Instruments**

The Company has chosen to adopt IFRS 9 and the disclosure requirements of Sections 11 and 12 of FRS 102 in respect of financial instruments.

*i) Financial assets*

Basic financial assets, including trade and other receivables, cash and bank balances and investments in commercial paper, are initially recognized at transaction price, unless the arrangement constitutes a financing transaction, where the transaction is measured at the present value of the future receipts discounted at a market rate of interest.

Such assets are subsequently carried at amortised cost using the effective interest rate method.

At the end of each reporting period financial assets measured at amortised cost are assessed for objective evidence of impairment. If an asset is impaired the impairment loss is the difference between the carrying amount and the present value of the estimated cash flows discounted at the asset's original effective interest rate. The impairment loss is recognized in income.

If there is a decrease in the impairment loss arising from an event occurring after the impairment was recognized the impairment is reversed. The reversal is such that the current carrying amount does not exceed what the carrying amount would have been had the impairment not previously been recognized. The impairment reversal is recognized in income.

Other financial assets, including investments in equity instruments which are not subsidiaries, associates or joint ventures, are initially measured at fair value, which is normally the transaction price. Such assets are subsequently carried at fair value whereby:

- a) listed investments are stated at market value on the balance sheet date,
- b) unlisted investments for which a market exists are stated at the average price at which they were traded on the balance sheet date or the last trading day before that date,
- c) for investments where market quotes are unavailable, the Company uses estimation techniques to determine fair value.

Changes in fair value are recognized in income, except that investments in equity instruments that are not publically traded and whose fair values cannot be measured reliably are measured at cost less impairment.

*ii) Financial liabilities*

Basic financial liabilities, including trade and other payables are initially recognised at transaction price.

Creditors arising out of reinsurance operations, amounts due to other group companies and other creditors are obligations to pay for services that have been acquired in the ordinary course of business. These obligations are classified as current liabilities if payment is due within one year or less. If not, they are presented as non-current liabilities.

Derivatives, including forward exchange contracts, are not basic financial instruments.

Derivatives are initially recognized at fair value on the date a derivative contract is entered into and are subsequently re-measured at their fair value. Changes in the fair value of derivatives are recognized in in finance costs or income as appropriate.

The Company does not currently apply hedge accounting for interest rate and foreign exchange derivatives.

Financial liabilities are derecognized when the liability is extinguished, that is when the contractual obligation is discharged, cancelled or expires.

*iii) Offsetting*

Financial assets and liabilities are offset and the net amounts presented in the financial statements when there is an enforceable right to set off the recognized amounts and there is an intention to settle on a net basis or to realise the asset and settle the liability simultaneously.

**NOTES TO THE FINANCIAL STATEMENTS (Continued)**

**3. Summary of significant accounting policies (continued)**

**(l) Share capital**

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

**(m) Distributions to equity holders**

Dividends and other distributions to the Company's shareholder are recognised as a liability in the period in which the dividends are approved. These amounts are recognised in the statement of changes in equity.

**(n) Related party transactions**

The Company discloses transactions with related parties which are not wholly owned with the same group. It does not disclose transactions with members of the same group that are wholly owned.

**4. Critical accounting judgements and estimation uncertainty**

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

*i) Claims reserves*

The establishment of claims reserves represents the area of greatest uncertainty in preparing insurance Company accounts. Reserves for future anticipated claims are made based on information available at the time of preparation of the accounts. Any "best estimate" of ultimate claims needs to be viewed as a point value within a likely range of outcomes. The nature of each insurer's business, and the reinsurance arrangements in place, influence how wide that likely range of outcomes will be.

Significant areas requiring estimation and judgment include;

- Estimates of the amount of any liability in respect of claims notified but not settled and incurred but not reported claims (IBNR) to be included within provisions for inward insurance and reinsurance contracts.
- The corresponding estimate of the amount of outwards reinsurance recoveries which will become due as a result of the estimated claims on inwards business.
- The recoverability of amounts due from reinsurers.

The estimation of claims incurred but not reported (IBNR) is generally subject to a greater degree of uncertainty than the estimation of the cost of settling claims already notified to the Company, where more information about the claim event is generally available. Claims IBNR may often not be apparent to the insured until many years after the event giving rise to the claims has happened. Classes of business where the IBNR proportion of the total reserve is high, such as casualty, will typically display greater variations between initial estimates and final outcomes because of the greater degree of difficulty of estimating these reserves. Classes where claims are typically reported relatively quickly after the claim event tend to display lower levels of volatility. In calculating the estimated cost of unpaid claims the Company uses a variety of estimation techniques, generally based upon statistical analyses of historical experience, which assumes that the development pattern of the current claims will be consistent with past experience.

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

- changes in the Company's underwriting and claims processes which might accelerate or slow down the development and/or recording of paid or incurred claims compared with the statistics from previous years
- changes in the legal environment
- the effects of inflation
- changes in mix of business
- the impact of large losses
- movements in industry benchmarks

A component of these estimation techniques is usually the estimation of the cost of notified but not paid claims. In estimating the cost of these claims the Company has regard to the claim circumstance as reported, any information available from cedants and information on the cost of settling claims with similar characteristics in previous years.

## ADVENT CAPITAL (No.3) LIMITED

### NOTES TO THE FINANCIAL STATEMENTS (Continued)

#### 4. Critical accounting judgements and estimation uncertainty (continued)

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

For major natural catastrophe events, the original loss estimate for all 'on risk' exposures is analysed using computer simulation to ascertain those accounts likely to be impacted. From the initial output, modelled loss estimates, per account, are generated. An underwriting review of the account, by cedant, is then conducted to validate the individual loss estimates and, where applicable, amend the model driven estimates with underwriter input relevant to the particular features of the loss and its anticipated impact on an account. Where accounts cannot be analysed, using catastrophe-modelling software, benchmark analysis is conducted, again on an account-by-account basis, to generate loss estimates. As more specific client information becomes available the ultimate loss estimates are updated from the initial forecast to reflect the client specific data.

Where possible, the Company adopts multiple techniques to estimate the required level of provisions. This assists in giving greater understanding of the trends inherent in the data being projected. The projections resulting from the various methodologies also assist in setting the range of possible outcomes. The most appropriate estimation technique is selected taking into account the characteristics of the business class and the extent of the development of each accident year.

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

Actual claims experience will always differ from projected estimates. Such differences in relation to risks previously earned are recognised in the income statement in the accounting period during which the difference is identified.

The Company's claims reserves are calculated by the Company's Head of Reserving with input from the Head of Claims and underwriters. These reserves are reviewed and approved monthly by the Reserve Group and quarterly by the Board. Annually, the reserves of the Syndicate are reviewed by external actuaries who issue a valuation opinion on the adequacy of reserves.

##### ii) Pipeline premiums

Written premiums include pipeline premiums which represent future premiums receivable on in-force insurance contracts. Pipeline premium estimates are typically based on underwriter knowledge and experience of the contracts being written and are updated regularly based on actual cash received versus estimate.

##### iii) Valuation of the deferred tax asset

In determining the recoverability of deferred tax assets, the Company primarily considers current and expected profitability of applicable operating companies and their ability to utilize any recorded tax assets. The Company reviews its deferred income tax assets on a regular basis, taking into consideration the underlying operations' performance as compared to plan, the outlook for the business going forward, the impact of enacted and proposed changes to tax law and the availability of tax planning strategies, including Group Relief with other UK subsidiaries of Fairfax Financial Holdings Limited (Fairfax).

#### 5. Foreign exchange risk management

The Company's operations are conducted in a number of currencies, the principal ones of which are US\$, £, CDN\$ and Euro. The Company's policy is that it is not in the business of taking or speculating on foreign currency risk. Its objective is to match each principal currency position.

On a monthly basis the Company reviews its consolidated foreign currency balance sheet, prepared in its principal currencies. Action is taken to reduce or mitigate foreign currency mismatches through the purchase or sale of the appropriate currencies or the use of forward exchange transactions where necessary.

The Company makes use of a currency translation service from Xchanging, whereby premiums and claims receivable in currencies outside the Syndicate's settlement currencies (currently US\$, £, CDN\$ and Euro) are translated at the spot rate of exchange to Sterling (or in some cases US\$) at the date of payment of the claim or receipt of the premium. Advent has used forward exchange contracts to hedge the expected settlement cost of claims in non-settlement currencies where required.

The principal exchange rates used in translating foreign currency assets, liabilities, income and expenditure in the preparation of these accounts were:

	2016		2015	
	Period average rate \$	Period end rate\$	Period average rate \$	Period end rate \$
Sterling	0.7382	0.8093	0.6543	0.6785
Euro	0.9032	0.9481	0.9017	0.9206
Canadian dollar	1.3230	1.3410	1.2772	1.3891

## ADVENT CAPITAL (No.3) LIMITED

### NOTES TO THE FINANCIAL STATEMENTS (Continued)

#### 5. Foreign exchange risk management (continued)

The Company's gross premiums were written in the following currencies:

	2016		2015	
	\$	%	\$	%
US dollar	215.1	83.4	191.8	79.8
£ sterling	30.4	11.8	29.8	12.4
Canadian dollar	4.3	1.7	4.6	1.9
Euro	8.0	3.1	14.3	5.9
	<u>257.8</u>	<u>100.0</u>	<u>240.5</u>	<u>100.0</u>

The Company's asset and liability positions in its major foreign currencies were as follows:

	US\$	£	CDN\$	€	NZ\$	JPY	AU\$
<b>31 December 2016</b>							
Total assets	632.0	32.9	30.7	41.8	0.2	-	7.2
Total liabilities	(392.5)	(57.2)	(14.2)	(22.0)	(14.6)	(71.7)	-
Net assets (net liabilities)	<u>239.5</u>	<u>(24.3)</u>	<u>16.5</u>	<u>19.8</u>	<u>(14.4)</u>	<u>(71.7)</u>	<u>7.2</u>
<b>31 December 2015</b>							
Total assets	697.9	76.0	31.2	57.4	5.2	68.2	12.0
Total liabilities	(392.0)	(104.6)	(17.1)	(47.9)	(24.0)	(300.6)	(9.5)
Net assets (net liabilities)	<u>305.9</u>	<u>(28.6)</u>	<u>14.1</u>	<u>9.5</u>	<u>(18.8)</u>	<u>(232.4)</u>	<u>2.5</u>

The effect on profit before tax of a 5% increase or decrease in the closing exchange rates on the foreign currency balance sheet at 31 December 2016 is approximately \$0.5 (2015: \$1.7) given the Company's policy of minimising foreign currency mismatches on a monthly basis.

The Company enters into forward exchange contracts to mitigate the exchange rate risk on its balance sheet. At 31 December 2016 the outstanding contracts mature within 6 months (2015: 6 months) of the year end. The Company is committed purchase NZ\$12.5 for exchange of GBP Sterling and €5.0 for exchange of US Dollars and to sell €10.0 for exchange of GBP Sterling and CAD\$11.0 for exchange of US Dollars.

The forward exchange contracts are measured at fair value, which is determined using valuation techniques that utilise observable inputs. The key assumptions used in valuing the derivatives are the forward exchange rates for USD:CAD and NZD:GBP.

#### 6. Insurance Risk Management

The Company is exposed to insurance risk through its underwriting activities. Insurance risk includes the risks that a policy will be written for too low a premium or provide inappropriate cover (underwriting risk), that the frequency or severity of insured events will be higher than expected (claims risk), or that estimates of claims subsequently prove to be insufficient (reserving risk). The Board sets the Company's overall risk appetite for insurance and catastrophe risk with specific parameters for risk set out in the approved annual business plan. Management of insurance risk on an operational basis is the responsibility of the Chief Underwriting Officer of Advent Underwriting Limited (AUL).

The Company writes property insurance and reinsurance business, including catastrophe-exposed business, and specialised lines including energy, marine, marine excess of loss and accident & health (A&H).

The Company manages its underwriting activities on a line of business basis with the four segments having the following insurance risk characteristics:

- The Reinsurance segment consists of the Company's property and casualty treaty reinsurance classes. The property treaty class offers property catastrophe and individual risk cover for insurance and reinsurance contracts written predominantly on a "losses occurring during policy period" basis with generally no risks in excess of 12 months and with a large proportion of risks expiring at 31 December each year. The casualty treaty class provides excess of loss coverage for general casualty classes such as auto liability, medical malpractice, workers compensation and associated exposures, with an emphasis on clash business. The majority of the account is written in the United States and no business is written on an unlimited basis.
- The Marine Insurance segment includes a broad range of products including marine, offshore energy portfolios with coverage provided for individual risk and catastrophe accumulations and marine hull & machinery, liability and cargo insurance. The energy portfolio consists of short tail offshore physical damage and operator's extra expense cover written on a direct basis.

# ADVENT CAPITAL (No.3) LIMITED

## NOTES TO THE FINANCIAL STATEMENTS (Continued)

### 6. Insurance Risk Management (continued)

Most risks are written on an excess or limited conditions basis with the objective of avoiding exposure to attritional losses. The marine hull & machinery, liability and cargo accounts are written on both a primary and excess direct basis, as well as through binding authorities.

- c) The Non-Marine Insurance segment comprises the Company's property, terrorism and accident & health insurance classes. The property classes include commercial property, personal lines and commercial automobile physical damage insurance written in the open market on both a lead and following basis, either through underwriting facilities or on an individual risk basis. The Terrorism account, which is written on both a direct basis and through binding authorities, provides cover for the risk of terrorist attacks and political violence on property throughout the world. The accident & health account provides a wide range of medical and accident coverage, primarily through binding authorities.  
Insurance Risk Management

- d) The discontinued segment includes classes of business written prior to 2012.

#### i) Segmental analysis

The tables below detail the Company's underwriting performance by segment. Acquisition costs, consisting of direct brokerage commissions, are allocated to each segment on a direct basis while operating costs, including underwriting costs, where they cannot be specifically attributed, are either allocated based on gross premiums written or gross premiums earned. The Company does not prepare a segmented balance sheet by line of business and accordingly, has presented key insurance account balances only.

#### 31 December 2016

	Reinsurance	Marine	Non-Marine Insurance	Discontinued	Underwriting result	Corporate & other	Total
	\$	\$	\$	\$	\$	\$	\$
Gross premiums written	47.6	44.6	165.8	(0.2)	257.8	-	257.8
Net premiums written	42.1	37.0	99.3	(1.4)	177.0	-	177.0
Net premiums earned	43.5	41.7	101.3	(1.4)	185.1	(1.4)	183.7
Net claims incurred	(18.0)	(24.4)	(65.7)	0.6	(107.5)	-	(107.5)
Acquisition costs	(5.0)	(11.9)	(24.4)	-	(41.3)	0.2	(41.1)
Operating expenses	(7.0)	(10.1)	(18.6)	(0.1)	(35.8)	-	(35.8)
<b>Underwriting profit (loss)</b>	<b>13.5</b>	<b>(4.7)</b>	<b>(7.4)</b>	<b>(0.9)</b>	<b>0.5</b>	<b>(1.2)</b>	<b>(0.7)</b>
Claims ratio	41.4%	58.5%	64.9%		58.1%	-	-
Acquisition cost ratio	11.5%	28.5%	24.1%		22.3%	-	-
Operating cost ratio	16.1%	24.2%	18.4%		19.3%	-	-
Expense ratio	27.6%	52.8%	42.4%		41.6%	-	-
<b>Combined ratio</b>	<b>69.0%</b>	<b>111.3%</b>	<b>107.3%</b>		<b>99.7%</b>	<b>-</b>	<b>-</b>
<b>Balance sheet accounts</b>							
Reinsurers' share of outstanding claims	16.2	4.5	15.4	9.2	45.3	-	45.3
Reinsurers' share of unearned premium	0.7	2.8	25.0	-	28.5	-	28.5
Deferred acquisition costs	2.3	5.4	19.4	-	27.1	(0.1)	27.0
Other assets	-	-	-	-	-	590.2	590.2
<b>Total assets</b>	<b>19.2</b>	<b>12.7</b>	<b>59.8</b>	<b>9.2</b>	<b>100.9</b>	<b>590.1</b>	<b>691.0</b>
Outstanding claims	(184.8)	(59.6)	(52.7)	(16.7)	(313.8)	-	(313.8)
Unearned premium	(17.6)	(20.4)	(69.1)	-	(107.1)	2.0	(105.1)
RI deferred acquisition costs	(0.2)	(0.4)	(7.9)	-	(8.5)	0.1	(8.4)
Other liabilities	-	-	-	-	-	(263.7)	(263.7)
<b>Total liabilities</b>	<b>(202.6)</b>	<b>(80.4)</b>	<b>(129.7)</b>	<b>(16.7)</b>	<b>(429.4)</b>	<b>(261.6)</b>	<b>(691.0)</b>

**ADVENT CAPITAL (No.3) LIMITED**
**NOTES TO THE FINANCIAL STATEMENTS (Continued)**
**6. Insurance Risk Management (continued)**
**31 December 2015**

	Reinsurance \$	Marine \$	Non-Marine Insurance \$	Discontinued \$	Underwriting result \$	Corporate & other \$	Total \$
Gross premiums written	56.5	51.1	132.7	0.2	240.5	-	240.5
Net premiums written	48.2	43.6	82.1	0.9	174.8	-	174.8
Net premiums earned	48.7	47.0	62.6	1.2	159.5	(1.6)	157.9
Net claims incurred	(20.6)	(26.2)	(39.1)	0.5	(85.4)	-	(85.4)
Acquisition costs	(4.3)	(13.7)	(16.8)	(0.1)	(34.9)	0.4	(34.5)
Operating expenses	(8.8)	(10.6)	(18.9)	(0.0)	(38.3)	(3.9)	(42.2)
<b>Underwriting profit (loss)</b>	<b>15.0</b>	<b>(3.5)</b>	<b>(12.2)</b>	<b>1.6</b>	<b>0.9</b>	<b>(5.1)</b>	<b>(4.2)</b>
Claims ratio	42.3%	55.7%	62.4%	(67.6%)	53.5%	-	-
Acquisition cost ratio	8.9%	29.2%	26.7%	6.0%	21.9%	-	-
Operating cost ratio	26.8%	22.5%	30.2%	7.6%	24.0%	-	-
Expense ratio	35.7%	51.7%	56.9%	13.6%	45.9%	-	-
<b>Combined ratio</b>	<b>69.1%</b>	<b>107.4%</b>	<b>119.3%</b>	<b>(54.0%)</b>	<b>99.4%</b>	<b>-</b>	<b>-</b>
<b>Balance sheet accounts</b>							
Reinsurers' share of outstanding claims	38.8	1.3	19.2	-	59.3	-	59.3
Reinsurers' share of unearned premium	1.6	2.4	19.6	-	23.6	-	23.6
Deferred acquisition costs	3.1	6.6	18.9	-	28.6	-	28.6
Other assets	-	-	-	-	-	546.2	546.2
<b>Total assets</b>	<b>43.5</b>	<b>10.3</b>	<b>57.7</b>	<b>-</b>	<b>111.5</b>	<b>546.2</b>	<b>657.7</b>
Outstanding claims	(225.4)	(32.2)	(58.8)	(32.1)	(348.5)	-	(348.5)
Unearned premium	(19.2)	(24.6)	(66.4)	-	(110.2)	0.9	(109.3)
RI deferred acquisition costs	(0.6)	(0.4)	(7.2)	-	(8.2)	-	(8.2)
Other liabilities	-	-	-	-	-	(191.7)	(191.7)
<b>Total liabilities</b>	<b>(245.2)</b>	<b>(57.2)</b>	<b>(132.4)</b>	<b>(32.1)</b>	<b>(466.9)</b>	<b>(190.8)</b>	<b>(657.7)</b>

All premiums are concluded in the United Kingdom.

The geographical analysis of gross premiums written by location is as follows:

	2016 \$	2015 \$
UK	60.7	58.6
Other EU	14.2	17.6
US and Canada	162.6	126.3
Other	20.3	38.0
	<b>257.8</b>	<b>240.5</b>



## NOTES TO THE FINANCIAL STATEMENTS (Continued)

## 6. Insurance Risk Management (continued)

## ii) Catastrophe Exposure

Lloyd's defines its own set of Realistic Disaster Scenarios (RDS) events for which all syndicates must report their exposures. The Company's pre-tax exposure, before and after reinsurance, to its major RDS scenarios are set out below:

Catastrophe event	Industry Loss	1 January 2017 Gross loss	1 January 2017 Net loss	1 January 2016 Gross loss	1 January 2016 Net loss
	US\$Bn	\$	\$	\$	\$
Florida Windstorm – Miami	131	90.3	18.6	72.8	24.0
Florida Windstorm – Pinellas	134	89.0	19.6	75.1	23.5
Gulf of Mexico Windstorm	111	87.1	16.8	78.8	21.9
USA North East Windstorm	81	49.7	18.5	52.2	21.1
Los Angeles Earthquake	78	106.5	21.0	94.4	27.8
European Windstorm	26	9.6	4.6	10.3	6.6
Japan Earthquake	71	12.0	6.5	13.3	9.2

As the catastrophe element of the underwriting portfolio remains Property Insurance biased, we maintain a more traditional Catastrophe excess of loss reinsurance structure for the 2016 underwriting year.

Our largest net wind scenario is a Florida (wind) event, driven mainly by the property open market and property binder portfolios, and would result in an estimated after tax loss of \$19.2 or 10.9% of required capital (2015: USA North East Windstorm catastrophe event: \$29.4 and 15.5% respectively).

The Company's approach to underwriting is governed by key principles which run throughout the underwriting units and are continuously monitored by management. Strict underwriting guidelines are adopted in terms of class of business, line size and in terms of policy periods, which are preferably limited to 12 months (plus odd time). The Company's policy is that it does not write excess of loss reinsurance contracts on an unlimited basis in any business segment. Any risk outside agreed guidelines must be approved by the Chief Underwriting Officer before the risk is underwritten and is reported to the Executive Committee. The Chief Underwriting Officer reports regularly to the Executive Committee and the Board on underwriting results against the approved business plan.

The Company uses reinsurance, including excess of loss and quota share reinsurance, to reduce the impact of probable maximum losses following major catastrophe events to levels within the Company's risk appetite for exposure to such catastrophe losses. The reinsurance programme is determined predominantly using the Company's 1:100 and 1:250 Exceedance Probability curves as a guide to the amount of cover required along with Advent's own perception of risk for the key areas and considers number of other factors including reinsurance security, availability of reinsurers and retrocessional reinsurers, pricing, terms and conditions and commercial relationships are reviewed prior to purchase. The key catastrophe protection is validated against prior year losses and the Solvency II Internal model to assess cost, benefits and efficiency of recoveries before confirming final purchase to the broker.

Specific protections are purchased to cover the major classes written and the programme is designed to provide significant vertical cover for major losses. The Company records all of its exposures and uses RDS analysis and industry accepted third party catastrophe modelling software to monitor and analyse its peak exposures and estimated losses, based on key concentrations of risk. For worldwide territories where catastrophe modelling software is not available, the Chief Underwriting Officer is responsible for reviewing and approving probable maximum loss estimates to ensure any catastrophe loss will be within the Company's approved risk appetite for that territory.

**ADVENT CAPITAL (No.3) LIMITED**
**NOTES TO THE FINANCIAL STATEMENTS (Continued)**
**6. Insurance Risk Management (continued)**
**iii) Claims outstanding**

The movement in the Company's claims reserves for the year ended 31 December 2016 is set out below:

<b>31 December 2016</b>	<b>Provision for unearned premiums</b>	<b>Claims outstanding</b>	<b>Total</b>
	<b>\$</b>	<b>\$</b>	<b>\$</b>
<b>Gross</b>			
At 1 January 2016	109.3	348.5	457.8
Exchange adjustments	(2.4)	(9.4)	(11.8)
Movements in provisions			
- Current year	(1.8)	154.2	152.4
- Prior years	-	(15.6)	(15.6)
- Paid claims	-	(163.9)	(163.9)
<b>At 31 December 2016</b>	<b>105.1</b>	<b>313.8</b>	<b>418.9</b>
<b>Reinsurers' share</b>			
At 1 January 2016	23.6	59.3	82.9
Exchange adjustments	-	(2.9)	(2.9)
Movements in provisions			
- Current year	4.9	23.4	28.3
- Prior years	-	7.7	7.7
- Paid recoveries	-	(42.2)	(42.2)
<b>At 31 December 2016</b>	<b>28.5</b>	<b>45.3</b>	<b>73.8</b>
<b>Net</b>			
<b>At 31 December 2016</b>	<b>76.6</b>	<b>268.5</b>	<b>345.1</b>
<b>31 December 2015</b>	<b>Provision for unearned premiums</b>	<b>Claims outstanding</b>	<b>Total</b>
	<b>\$</b>	<b>\$</b>	<b>\$</b>
<b>Gross</b>			
At 1 January 2015	80.6	374.6	455.2
Exchange adjustments	(1.6)	(9.7)	(11.3)
Movements in provisions			
- Current year	30.3	132.0	162.3
- Prior years	-	(32.2)	(32.2)
- Paid claims	-	(116.2)	(116.2)
<b>At 31 December 2015</b>	<b>109.3</b>	<b>348.5</b>	<b>457.8</b>
<b>Reinsurers' share</b>			
At 1 January 2015	10.1	70.0	80.1
Exchange adjustments	-	(3.0)	(3.0)
Movements in provisions			
- Current year	13.5	23.1	36.6
- Prior years	-	(7.6)	(7.6)
- Paid recoveries	-	(23.2)	(23.2)
<b>At 31 December 2015</b>	<b>23.6</b>	<b>59.3</b>	<b>82.9</b>
<b>Net</b>			
<b>At 31 December 2015</b>	<b>85.7</b>	<b>289.2</b>	<b>374.9</b>

For the year ended 31 December 2016, improvement in prior years' claims, net of reinstatement premiums and reinsurance recoveries, amounted to \$23.3 (2015: \$24.6).

# ADVENT CAPITAL (No.3) LIMITED

## NOTES TO THE FINANCIAL STATEMENTS (Continued)

### 6. Insurance Risk Management (continued)

The claims balance is further analysed between notified outstanding claims and IBNR below:

	2016		2015	
	Gross \$	Net \$	Gross \$	Net \$
Notified outstanding claims	115.5	100.9	132.7	109.0
IBNR	198.3	167.6	215.8	180.2
<b>Outstanding claims</b>	<b>313.8</b>	<b>268.5</b>	<b>348.5</b>	<b>289.2</b>
Percentage of IBNR to notified outstanding claims	172%	166 %	163%	165%

The breakdown of the gross and net claims reserves by category of claims is set out below.

	2016		2015	
	Gross \$	Net \$	Gross \$	Net \$
Large catastrophe provisions	23.9	10.1	48.5	20.9
All other short tail provisions	148.7	117.1	164.7	133.0
Long-tail casualty provisions	141.2	141.3	135.3	135.3
<b>Total</b>	<b>313.8</b>	<b>268.5</b>	<b>348.5</b>	<b>289.2</b>

Large catastrophe provisions include major hurricanes and earthquakes. All other short tail provisions represent coverages where the majority of claims are expected to be reported within two years of the occurrence of the claim. Long tail provisions consist of Syndicate 780's casualty and personal accident accounts.

The projected pay out of the ultimate gross and net claims reserves at 31 December 2016 is as follows:

Payment within	1 year	2 years	3 years	4 years	5 years	More than 5 years
	\$	\$	\$	\$	\$	\$
Gross	115.3	66.2	36.0	24.3	18.7	53.3
Net	98.5	56.6	30.7	20.7	15.9	46.1

The pay out patterns have been estimated based on the historical payment patterns at a class of business level. Future payment patterns are inherently uncertain.

Unearned premiums are expected to be earned approximately 88% in 2017 and the balance in 2018.

The following table shows the adverse or favourable development of claims, on a gross and net basis, determined on an accident year basis, from the amounts originally estimated at the end of the preceding year. Claims in currencies other than US dollars have been reconverted at 31 December 2016 exchange rates for all accident years.

# ADVENT CAPITAL (No.3) LIMITED

## NOTES TO THE FINANCIAL STATEMENTS (Continued)

### 6. Insurance Risk Management (continued)

#### Gross earned claims

Earned gross claims Accident year	2007 and prior	2008	2009	2010	2011	2012	2013	2014	2015	2016	Total
	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$
At the end of accident year	2,336	240	106	223	360	126	117	111	130	152	
One year later	2,330	259	122	204	365	135	117	107	141		
Two years later	2,328	247	119	199	346	129	110	103			
Three years later	2,318	239	116	193	325	127	101				
Four years later	2,310	244	104	191	350	124					
Five years later	2,274	239	106	203	342						
Six years later	2,251	239	108	202							
Seven years later	2,245	243	108								
Eight years later	2,292	243									
Nine years later	2,286										
Cumulative claims	2,286	243	108	202	342	124	101	103	141	152	3,804
Cumulative paid	2,263	238	99	188	322	98	72	68	99	44	3,490
Claims reserve	23	5	9	15	21	26	29	35	43	108	314
(Favourable) unfavourable development	(6)	0	0	(1)	(8)	(2)	(9)	(4)	11		(18)

\* Gross Claims reserves per balance sheet of \$314 include additional claims handling of \$3.9.

Earned Net Claims Accident year	2007 and prior	2008	2009	2010	2011	2012	2013	2014	2015	2016	Total
	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$
At the end of accident year	1,682	198	90	139	200	115	106	94	106	129	
One year later	1,674	216	108	128	205	117	110	90	108		
Two years later	1,660	210	106	132	209	112	103	87			
Three years later	1,663	207	102	129	195	110	95				
Four years later	1,680	203	97	130	190	108					
Five years later	1,671	203	99	131	182						
Six years later	1,676	203	96	130							
Seven years later	1,664	202	96								
Eight years later	1,663	202									
Nine years later	1,657										
Cumulative claims	1,657	202	96	130	182	108	95	87	108	129	2,795
Cumulative paid	1,635	197	88	121	167	84	67	56	78	34	2,527
Claims reserve	23	5	9	8	16	25	28	31	30	95	268
(Favourable) unfavourable development	(5)	(1)	0	(1)	(7)	(2)	(8)	(3)	3		(23)

\* Net Claims reserves per balance sheet of \$314 include additional claims handling of \$3.9.

# ADVENT CAPITAL (No.3) LIMITED

## NOTES TO THE FINANCIAL STATEMENTS (Continued)

### 6. Insurance Risk Management (continued)

#### iv) Outwards reinsurance

#### Ceded reinsurance written:

The Company's reinsurance costs as a percentage of gross written premiums are set out below:

	2016	2015
	\$	\$
Gross premiums written (GPW)	257.8	240.5
Ceded reinsurance premiums (third party)	(21.3)	(19.6)
Ceded reinsurance premiums (affiliate)	(59.5)	(46.1)
Total reinsurance premiums	(80.8)	(65.7)
Net premiums written	177.0	174.8
Third party reinsurance premiums as a percentage of GPW	8.3%	8.2%

The security of the Company's proposed and existing reinsurers is reviewed and approved by the Outwards Reinsurance Committee, to ensure that the outward placements are with reinsurers of an acceptable level of security. The core list of approved reinsurers currently consists of 13 (2015: 14) Lloyd's syndicates and 24 (2015:14) reinsurance companies all of which are rated A- or higher, or where policy limits are fully collateralised.

Reinsurers are selected depending on their rating by either AM Best or Standard & Poors. No reinsurer is selected with a rating below A except in specific circumstances and with the prior approval of the Advent's Outwards Reinsurance Committee or where the policy limits are fully collateralised by acceptable security, currently US Treasury bills or equivalent funds. The Company's exposure under its reinsurance programmed expiring 1 April 2017 is provided by reinsurers rated as follows:

Reinsurers	Exposure
	\$
A++	10.0
A+ Companies	37.3
A+ Lloyd's syndicates	22.3
A Companies	73.2
A- Companies	4.6
Not rated – fully collateralised limits	23.3
<b>Total exposure</b>	<b>170.7</b>

The Company reviews amounts due from reinsurers on paid losses, amounts recoverable from reinsurers on outstanding losses and amounts in dispute to determine if a provision for bad debts is required. The Company's policy is to provide for reinsurer bad debts in situations where it does not expect to collect the full amount outstanding due to the financial position of the reinsurer or due to disputes over coverage.

#### Reinsurance recoverable:

At 31 December 2016, the Company's reinsurance recoverable on outstanding claims amounted to \$45.3 with reinsurers who had the following risk ratings by AM Best (or equivalent S&P rating in the absence of an AM Best rating):

Risk Rating	\$	%
A+	5.0	11.1
Lloyd's	1.2	2.7
A	16.5	36.5
A-	0.5	1.1
Affiliates	22.1	48.6
<b>Total</b>	<b>45.3</b>	<b>100.0</b>

Trust funds of \$23.3 are held as security for certain balances from affiliates.

# ADVENT CAPITAL (No.3) LIMITED

## NOTES TO THE FINANCIAL STATEMENTS (Continued)

### 6. Insurance Risk Management (continued)

#### v) Debtors arising from insurance and reinsurance operations

The table below sets out the analysis of the debtors arising from insurance and reinsurance operations, at cost and fair value.

	2016	2015
	\$	\$
Insurance and reinsurance premiums due	12.8	20.3
Pipeline premium	66.7	73.7
Reinsurance recoveries on paid claims	6.6	4.0
	<u>86.1</u>	<u>98.0</u>

Pipeline premium represents amounts receivable in respect of premiums incepted on binder business for which notification from the broker has not yet been received, together with reinstatement premiums on claims. The estimate of the likely settlement date for reinstatement premiums due is intrinsically related to the estimate of the likely settlement dates for the major losses. Almost all of this balance would generally be expected to be recovered within one year.

The reinsurance recoveries accrued on paid claims is further analysed below:

	2016	2015
	\$	\$
Fully performing	6.6	4.0
Past due	-	-
	<u>6.6</u>	<u>4.0</u>

Of the remaining debtor balances, it is expected that substantially all of the insurance and reinsurance premiums due and approximately 88% of the deferred acquisition costs will be received or expensed within one year. Other than reinsurance recoveries as noted above all of these debtors are fully performing.

#### vi) Sensitivity analysis

The Company is subject to Insurance risk from three sources, underwriting risk, claims risk and reserve risk.

#### Underwriting risk:

The risk that a policy will be written for too low a premium or provide inappropriate cover. The Company is exposed to general market trends around the pricing of (re) insurance, consequently premiums received for a given level of cover can vary from plan.

The table below shows the impact on the Company's result further to the general pricing environment varying by 5% and 10% compared to actual experience. This impact is assumed to result in net earned premiums increasing or decreasing in proportion to the pricing variance, whilst claims experience remains constant.

31 December 2016	-10%	-5%	Actual result	+5%	+10%
	\$	\$	\$	\$	\$
Net premiums earned	165.3	174.5	183.7	192.9	202.0
Net claims incurred	(107.5)	(107.5)	(107.5)	(107.5)	(107.5)
Profit (loss) before tax	(6.0)	3.2	12.4	21.5	30.7
Combined ratio	111.5%	105.7%	100.4%	95.6%	91.2%
31 December 2015 (re-stated)	\$	\$	\$	\$	\$
Net premiums earned	142.1	150.0	157.9	165.8	173.7
Net claims incurred	(85.4)	(85.4)	(85.4)	(85.4)	(85.4)
Profit (loss) before tax	(53.5)	(45.6)	(37.7)	(29.8)	(21.9)
Combined ratio	114.1%	108.1%	102.7%	97.8%	93.3%

# ADVENT CAPITAL (No.3) LIMITED

## NOTES TO THE FINANCIAL STATEMENTS (Continued)

### 6. Insurance Risk Management (continued)

#### Claims risk:

The risk that the frequency or severity of insured events will be higher than expected.

The table below shows the impact on the Company's results further to claims experience in the year varying by 5% and 10% compared to actual experience. This impact is assumed to result in net claims incurred increasing or decreasing proportionately, whilst all other balances remain constant.

31 December 2016	-10%	-5%	Actual result	+5%	+10%
	\$	\$	\$	\$	\$
Net premiums earned	183.7	183.7	183.7	183.7	183.7
Net claims incurred	(96.7)	(112.9)	(107.5)	(102.1)	(118.2)
<b>Profit (loss)</b>	<b>23.1</b>	<b>7.0</b>	<b>12.4</b>	<b>17.7</b>	<b>1.6</b>
<b>Combined ratio</b>	<b>94.5%</b>	<b>97.4%</b>	<b>100.4%</b>	<b>103.3%</b>	<b>106.2%</b>
<b>31 December 2015 (re-stated)</b>					
Net premiums earned	157.9	157.9	157.9	157.9	157.9
Net claims incurred	(76.8)	(81.1)	(85.4)	(89.6)	(93.9)
<b>Profit (loss)</b>	<b>(29.2)</b>	<b>(33.4)</b>	<b>(37.7)</b>	<b>(42.0)</b>	<b>(46.2)</b>
<b>Combined ratio</b>	<b>97.3%</b>	<b>100.0%</b>	<b>102.7%</b>	<b>105.4%</b>	<b>108.1%</b>

#### Reserve risk:

The risk that estimates of claims subsequently prove to be insufficient.

The table below shows the impact on the Company's results further to an additional deterioration (negative) or improvement in the Company's opening net reserves of 5% and 10% compared to actual experience.

31 December 2016	-10%	-5%	Actual result	+5%	+10%
	\$	\$	\$	\$	\$
Net premiums earned	183.7	183.7	183.7	183.7	183.7
Net claims incurred	(136.4)	(122.0)	(107.5)	(93.0)	(78.6)
<b>Profit (loss)</b>	<b>(16.6)</b>	<b>(2.1)</b>	<b>12.4</b>	<b>26.8</b>	<b>41.3</b>
<b>Combined ratio</b>	<b>116.1%</b>	<b>108.2%</b>	<b>100.4%</b>	<b>92.5%</b>	<b>84.6%</b>
<b>31 December 2015 (re-stated)</b>					
Net premiums earned	157.9	157.9	157.9	157.9	157.9
Net claims incurred	(122.8)	(104.1)	(85.4)	(66.6)	(47.9)
<b>Profit (loss)</b>	<b>(75.1)</b>	<b>(56.4)</b>	<b>(37.7)</b>	<b>(18.9)</b>	<b>(0.2)</b>
<b>Combined ratio</b>	<b>126.3%</b>	<b>114.5%</b>	<b>102.7%</b>	<b>90.8%</b>	<b>78.9%</b>

### 7. Financial Risk Management

#### i) Financial Instruments

	Market value		Cost	
	2016	2015	2016	2015
	\$	\$	\$	\$
Equities	82.2	87.8	146.9	164.3
Debt securities and other fixed income securities	350.9	277.4	339.1	266.1
Other investments	1.8	4.8	22.2	22.2
Overseas deposits	11.6	13.8	11.6	24.4
Investment pools	25.6	24.1	25.0	13.8
	<b>472.1</b>	<b>407.9</b>	<b>544.8</b>	<b>490.8</b>

## ADVENT CAPITAL (No.3) LIMITED

### NOTES TO THE FINANCIAL STATEMENTS (Continued)

#### 7. Financial Risk Management (continued)

Overseas deposits are lodged as a condition of conducting underwriting business in certain countries.

At 31 December 2016, investments of \$124.1 (2015: \$122.9) were held in US situs and other regulatory deposits available for the payment of claims in those jurisdictions and are not available for the payment of other claims and obligations.

At 31 December 2016, cash and investments of \$265.8 (2015: \$253.0) were held within FIS to support the Syndicate's underwriting activities and for uncalled losses.

##### ii) Fair value estimation

FRS 102 requires the Company to categorise its investment portfolio in terms of the quality of the pricing information used to value the individual assets. The different levels have been defined as follows:

All short dated government debt is classified as Level 1, as there is an active market and prices are available from multiple sources. The Company has also designated its equity portfolio as Level 1 as all holdings are listed on recognised exchanges with observable prices. The Company's participation in overseas deposits is split between Levels 1 and 2 based upon information provided by Lloyd's.

Determinations to classify fair value measures within Level 3 of the valuation hierarchy are generally based on the significance of the unobservable factors to the overall fair value measurement. Included in the Level 3 classification are deflation derivatives and investments in convertible debentures. The Company has categorised the deflation derivatives as Level 3 due to the pricing being model derived from a single broker. The Company has categorised the convertible debentures as Level 3 as they are unrated and not frequently traded.

The remainder of the portfolio is considered to be Level 2, as these assets are valued based upon prices quoted in markets that are less active, have fewer sources or are derived from prices quoted in an active market.

The following table presents the Company's assets that are measured at fair value, together with an analysis of when they mature.

##### At 31 December 2016

	Total \$	Less than 1 year \$	1 to 2 years \$	2 to 3 years \$	More than 3 years \$
<b>Level 1</b>					
Equities	69.8	-	-	-	-
Debt securities and other fixed income securities	250.9	-	250.9	-	-
Overseas deposits	6.9	4.5	0.9	1.2	0.3
	<b>327.6</b>	<b>4.5</b>	<b>251.8</b>	<b>1.2</b>	<b>0.3</b>
<b>Level 2</b>					
Equities	12.4	-	-	-	-
Debt securities and other fixed income securities	87.0	-	-	-	87.0
Overseas deposits	4.7	1.0	1.5	1.3	0.9
Forward exchange contracts	0.3	0.3	-	-	-
Holdings in collective investment schemes	23.6	-	-	-	-
	<b>128.0</b>	<b>1.3</b>	<b>1.5</b>	<b>1.3</b>	<b>87.9</b>
<b>Level 3</b>					
Deflation derivatives	1.5	-	-	-	1.5
Convertible debentures	13.0	-	-	-	13.0
Holdings in collective investment schemes	2.0	-	-	-	-
	<b>16.5</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>14.5</b>
	<b>472.1</b>	<b>5.8</b>	<b>253.3</b>	<b>2.5</b>	<b>102.7</b>



# ADVENT CAPITAL (No.3) LIMITED

## NOTES TO THE FINANCIAL STATEMENTS (Continued)

### 7. Financial Risk Management (continued)

At 31 December 2015	Total \$	Less than 1 year \$	1 to 2 years \$	2 to 3 years \$	More than 3 years \$
<b>Level 1</b>					
Debt securities and other fixed income securities	157.6	157.6	-	-	-
Equities	77.5	-	-	-	-
Overseas deposits	8.1	2.4	4.2	1.1	0.4
	<u>243.2</u>	<u>160.0</u>	<u>4.2</u>	<u>1.1</u>	<u>0.4</u>
<b>Level 2</b>					
Debt securities and other fixed income securities	105.4	-	-	-	105.4
Equities	10.3	-	-	-	-
Forward exchange contracts	1.1	1.1	-	-	-
Holdings in collective investment schemes	22.3	-	-	-	-
Overseas deposits	5.7	1.9	1.2	1.4	1.2
	<u>144.8</u>	<u>3.0</u>	<u>1.2</u>	<u>1.4</u>	<u>106.6</u>
<b>Level 3</b>					
Deflation derivatives	3.7	-	-	-	3.7
Convertible debentures	14.4	-	-	-	14.4
Holdings in collective investment schemes	1.8	-	-	-	-
	<u>19.9</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>18.1</u>
	<u>407.9</u>	<u>163.0</u>	<u>5.4</u>	<u>2.5</u>	<u>125.1</u>

The maximum loss to the Company from the deflation derivative investments is the market value of \$1.5 at 31 December 2016 (2015: \$3.6 million). Level 3 investment movements are summarised as follows:

	2016 \$	2015 \$
Balance at 1 January	19.9	14.2
Purchase of investments	0.0	5.6
Profit (loss) recognised in the income statement	(3.4)	0.1
Balance at 31 December	<u>16.5</u>	<u>19.9</u>

#### iii) Interest rate risk

The table below sets out the sensitivity of the Company's fixed income portfolio to unexpected changes in interest rates.

Change in Interest rates (Basis points)	\$
+200	(21.3)
+100	(11.6)
-100	14.10
-200	31.2

#### iv) Liquidity risk

Liquidity risk is the risk that cash may not be available to pay obligations when due. The Company monitors its liquidity needs through daily monitoring and monthly cash flow forecasts.

#### v) Credit risk

Credit risk is the risk that a counterparty will be unable to pay amounts in full when due. Key areas where the Company is exposed to credit risk are:

- amounts due from corporate bondholders;
- amounts due from reinsurers on paid and outstanding losses;
- amounts due from policyholders and intermediaries; and
- counterparty risk with respect to derivative transactions.

# ADVENT CAPITAL (No.3) LIMITED

## NOTES TO THE FINANCIAL STATEMENTS (Continued)

### 7. Financial Risk Management (continued)

The Company places limits on its exposure to any single counterparty for investments and reinsurers and to geographical and industry segments. The tables below summarise the assets subject to credit risk by Standard & Poors (S&P) credit rating or equivalent where no S&P rating is available.

#### At 31 December 2016

	AAA	AA	A	BBB	Below BBB	Not Rated	Total
	\$	\$	\$	\$	\$	\$	\$
Debt securities	227.8	61.9	10.4	23.9	26.9	-	350.9
Collective investment schemes	-	-	-	-	12.8	12.8	25.6
Overseas deposits	6.6	1.5	1.4	0.4	-	1.7	11.6
Derivatives	-	-	-	-	-	1.8	1.8
Reinsurance recoverable	-	-	45.3	-	-	-	45.3
Other assets	-	-	-	-	-	8.2	8.2
Cash and cash equivalents	-	-	17.4	-	-	-	17.4
<b>Total</b>	<b>234.4</b>	<b>63.4</b>	<b>74.5</b>	<b>24.3</b>	<b>39.7</b>	<b>24.5</b>	<b>460.8</b>

#### At 31 December 2015

	AAA	AA	A	BBB	Below BBB	Not Rated	Total
	\$	\$	\$	\$	\$	\$	\$
Debt securities	175.9	91.6	3.8	-	6.1	-	277.4
Collective investment schemes, equities and other investments	-	-	-	-	-	24.1	24.1
Overseas deposits	8.4	3.2	1.9	0.3	-	-	13.8
Derivatives	-	-	-	-	-	4.8	4.8
Reinsurance recoverable	-	-	59.3	-	-	-	59.3
Other assets	-	-	-	-	-	6.6	6.6
Cash and cash equivalents	-	1.8	21.2	-	-	-	23.0
<b>Total</b>	<b>184.3</b>	<b>96.6</b>	<b>86.2</b>	<b>0.3</b>	<b>6.1</b>	<b>35.5</b>	<b>409.0</b>

Collateral is provided to the Company as security over reinsurance recoverable balances due from some reinsurers. At 31 December 2016, collateral totalling \$23.7 was available to the Company (2015: \$34.2). No other collateral is provided for the benefit of the Company.

Debtors arising from insurance and reinsurance operations comprise premiums due from insureds and reinsureds, but not paid at 31 December 2016. The balance includes reinstatement premiums due on losses, which will be collected when the associated claims are paid.

### 8. Profit (loss) on ordinary activities before tax

Profit (loss) is stated after charging:

	2016	2015
	\$	\$
Audit fees payable to the Company's auditors	0.3	0.4
Amortisation of syndicate capacity	0.4	0.6

In accordance with SI 2008/489 the Company has not disclosed the fees payable to the Company's auditor for 'Other services' as this information is included in ACH's financial statements.

**ADVENT CAPITAL (No.3) LIMITED****NOTES TO THE FINANCIAL STATEMENTS (Continued)****9. Investment return**

	2016 \$	2015 \$
Investment income		
Income from financial investments	10.9	7.4
Gains on the realisation of investments	15.6	10.8
Losses on the realisation of investments	(25.1)	(4.9)
	<u>1.4</u>	<u>13.3</u>
Investment expenses and charges		
Investment management expenses	(1.4)	(1.5)
	<u>(1.4)</u>	<u>(1.5)</u>
Unrealised gains on investments	22.3	3.6
Unrealised losses on investments	(22.0)	(54.2)
	<u>0.3</u>	<u>(50.6)</u>
Total investment return	<u><u>0.3</u></u>	<u><u>(38.8)</u></u>

**10. Net Operating Expenses**

	2016 \$	2015 \$
Acquisition costs	39.7	40.6
Change in deferred acquisition costs	1.3	(6.0)
Administrative expenses	35.9	42.1
	<u>76.9</u>	<u>76.7</u>

**11. Employees & Directors**

The Company does not have any employees. The Company is charged a single management charge by ACH based on the total actual expenses of the group companies that employ staff, which is included in net operating expenses. The specific element of the costs of employees or Directors are therefore not identified. The Executive Directors' emoluments are included in the key management emoluments as disclosed in ACH's financial statements.

# ADVENT CAPITAL (No.3) LIMITED

## NOTES TO THE FINANCIAL STATEMENTS (Continued)

### 12. Tax provision

	2016 \$	2015 \$
<b>Tax expense included in profit and loss</b>		
<b>Current tax:</b>		
Profit (loss) multiplied by standard rate of corporation tax in the UK of 20% (2015: 20.25%)	2.6	(7.6)
Effects of:		
Results not yet taxed	0.3	9.4
Effect of transfer pricing adjustment	(0.8)	(0.8)
Other adjustments	(0.2)	(0.6)
Prior years' adjustment	(0.5)	0.2
<b>Total current tax</b>	<b>1.4</b>	<b>0.6</b>
<b>Deferred tax:</b>		
Origination and reversal of timing difference	(0.3)	(9.4)
Effect of tax rate change on opening balance	1.3	0.1
Prior years' adjustment	1.3	(0.3)
<b>Total deferred tax</b>	<b>2.3</b>	<b>(9.6)</b>
<b>Tax on profit (loss)</b>	<b>3.7</b>	<b>(9.0)</b>

### Factors that may affect future tax charges

Deferred tax is provided on the annually accounted technical result of each underwriting YOA. A deferred tax asset is only recognised where forecasts show that the taxable loss will be utilised in the foreseeable future.

The Company incurs US tax on its share of the Syndicate's deemed US underwriting profits. This tax is recoverable to the extent that UK tax arises on taxable Syndicate profits for the appropriate years of account (YOA). Some US tax incurred will be irrecoverable due to the differences between UK and US tax rates and the timing of US and UK syndicate profits for tax purposes.

Deferred tax is provided on the technical account in respect of open YOA which remain undistributed at 31 December 2016, namely the 2014, 2015 and 2016 years of account. As the functional currency of the Company is US dollars, the assets/liabilities provided are based on the dollar reported value of the open YOA result. As final distribution of the relevant years of account will be determined in Sterling, the ultimate taxation liability of open YOA may therefore change as a result of valuation changes between US dollar and Sterling in the interim period.

Deferred tax has been calculated on balances expected to reverse in 2017 at 19%, and at 17% for those expected to reverse thereafter.

# ADVENT CAPITAL (No.3) LIMITED

## NOTES TO THE FINANCIAL STATEMENTS (Continued)

### 13. Intangible assets

	2016	2015
	\$	\$
<b>Syndicate Underwriting Capacity</b>		
<b>Cost</b>	<u>7.9</u>	<u>7.9</u>
<b>Accumulated Depreciation</b>		
At 1 January	7.5	6.9
Charge for the year	0.4	0.6
<b>At 31 December</b>	<u>7.9</u>	<u>7.5</u>
<b>Net Book Value</b>	<u>-</u>	<u>0.4</u>

### 14. Called up share capital

	2016	2015
	\$	\$
Allotted and fully paid		
200,001 (2014: 200,001) Ordinary shares of \$0.40 each	0.1	0.1

### 15. Related parties and parent Company

The immediate parent undertaking is ACH. ACH is the parent undertaking of the smallest group of undertakings to consolidate these financial statements. The consolidated financial statements of ACH can be obtained from 2nd Floor, 2 Minster Court, Mincing Lane, London EC3R 7BB.

The ultimate parent undertaking and controlling party is Fairfax Financial Holdings Limited (Fairfax), a Company incorporated in Canada. Fairfax is the parent undertaking of the largest group of undertakings to consolidate these financial statements at 31 December 2016. The consolidated financial statements of Fairfax are available from 95 Wellington Street West, Suite 800, Toronto, Ontario, Canada, M5J 2N7.

The Company has carried out transactions with fellow subsidiaries of Fairfax during the year. Inwards reinsurance premiums from related parties are set out below.

	2016	2015
	\$	\$
Polish Re	1.1	7.9
Crum and Forster	0.0	0.0
Zenith National Insurance Corp.	0.2	0.2
Hudson Insurance Company	-	0.4
Odyssey Reinsurance Company	1.6	-
Brit Limited	1.6	1.3
	<u>4.5</u>	<u>9.8</u>

Ceded outwards reinsurance premiums and related reinsurance recoveries to and from related parties are set out in the table below.

	Reinsurance Premiums		Reinsurance Recoveries	
	2016	2015	2016	2015
	\$	\$	\$	\$
Wentworth Insurance Company Ltd	4.9	9.0	0.6	2.9
Polish Re	0.0	0.2	(0.1)	(0.1)
Odyssey Reinsurance Company	2.9	2.8	0.4	0.5
Brit Limited	0.1	-	-	-
Crum and Forster	51.6	34.0	26.5	12.0
	<u>59.5</u>	<u>46.0</u>	<u>27.4</u>	<u>15.3</u>

The Company incurred investment management fees to Hamblin Watsa Investment Counsel of \$1.3 (2015: \$1.5).

All transactions with these parties were conducted at arm's length and at normal commercial terms.