

Arch Europe Insurance Services Ltd
(Registered number: 06645619)

**Annual Report and Financial Statements
For the year ended 31 December 2016**



Annual Report and Financial Statements for the year ended 31 December 2016

Contents	Page
Strategic Report for the year ended 31 December 2016	1
Directors' Report for the year ended 31 December 2016	3
Independent Auditors' Report to the Members of Arch Europe Insurance Services Ltd	6
Statement of Comprehensive Income for the year ended 31 December 2016	8
Statement of Financial Position as at 31 December 2016	9
Statement of Changes in Equity for the year ended 31 December 2016	10
Notes to the Financial Statements	11
Directors and Administration	23

Strategic Report for the year ended 31 December 2016

The directors present their strategic report of Arch Europe Insurance Services Ltd (“the Company”) for the year ended 31 December 2016.

Principal Activities and Business Review

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

Results and Dividends

The Company’s result for the year is a profit and total comprehensive income for year of £2.2m (2015: £1.1m) generated through a secondment and service charge received from AICE and AUAL.

During the year, the Company paid a dividend of £0.80 per ordinary share (2015: £0.80).

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

	2016	2015
Revenue	£37.9m	£35.2m
Operating Profit	£0.9m	£1.6m
Profit and total comprehensive income for the year	£0.1m	£1.1m

Principal Risks and Uncertainties

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

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

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

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

Strategic Report for the year ended 31 December 2016 (*continued*)

Management of Risks

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

Operational Risk

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

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

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

The Company's largest outsource service provider is Ins-Sure Services Limited (Xchanging).

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

Credit Risk

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

Liquidity Risk

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

Interest Rate Cash Flow Risk

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

Capital Risk

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

Future Outlook

The Company expects a similar level of turnover in 2017. As there are no expected changes to the service and secondment margin charged, the level of operating profit to turnover is expected to remain consistent with the current year.



J. Kittinger
Finance Director

Directors' Report for the year ended 31 December 2016

The Directors present their annual report of Arch Europe Insurance Services Ltd ("the Company") and the audited financial statements for the year ended 31 December 2016.

General Information

Arch Europe Insurance Services Ltd is a UK incorporated company domiciled in England and Wales, the address of the registered office is provided on the Directors and Administration page.

Ownership

The Company's ultimate parent company is Arch Capital Group Ltd ("ACGL"), a Bermuda-based company with \$10.5 billion (2015: \$7.1 billion) of capital, comprised of shareholders' equity and debt, at 31 December 2016. Through operations in Bermuda, the United States, Europe and Canada, ACGL provides insurance and reinsurance on a worldwide basis. ACGL is listed on the NASDAQ U.S. stock exchange.

The Company is directly owned by Arch Insurance Company (Europe) Limited ("AICE"), a Prudential Regulation Authority ("PRA") regulated insurance company that underwrites Property, Energy, Marine, Personal Accident, Executive Assurance, Professional Liability and General Liability insurance business with a focus on Specialty lines of insurance.

Corporate and Social Responsibility

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

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

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

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

At the end of 2016, the Company had 138 staff. To ensure we maintain high performance standards across the organisation we conduct detailed annual appraisals focusing on identifying skills gaps and ensuring professional capabilities are maintained and advanced.

Directors

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

D. Hipkin	(Resigned 31 December 2016)
J. Kittinger	
M. Shulman	(Appointed 28 September 2016)
B. Singh	
J. Weatherstone	(Resigned 17 November 2016)

Directors' Report for the year ended 31 December 2016 (continued)

Financial Risk Management

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

Principal Activities

Please refer to the Strategic Report on page 1.

Business Review

Please refer to the Strategic Report on page 1.

Principal Risk and Uncertainties

Please refer to the Strategic Report on page 1.

Future Developments

Please refer to the Strategic Report on page 2.

Statement of directors' responsibilities

The directors are responsible for preparing the Strategic Report, Directors' Report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have prepared the financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice), including Financial Reporting Standard 101 Reduced Disclosure Framework (FRS 101).

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 101, have been followed, subject to any material departures disclosed and explained in the financial statements;
- notify the Company's shareholders in writing about the use of disclosure exemptions, if any, of FRS 101 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.

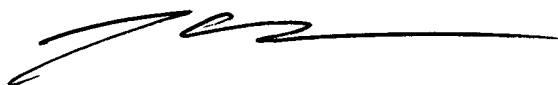
Directors' Report for the year ended 31 December 2016 *(continued)*

Statement of disclosure of information to independent auditors

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

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

Approved by the Board and signed on behalf of the Board



J. Kittinger
Finance Director

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

Report on the financial statements

Our opinion

In our opinion, Arch Europe Insurance Services Ltd'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

Arch Europe Insurance Services Ltd's financial statements comprise:

- the Statement of Financial Position as at 31 December 2016;
- the Statement of Comprehensive Income for the year then ended;
- the Statement of Changes in Equity for the year then ended; and
- the notes to the financial statements, which include a summary of significant accounting policies and other explanatory information.

The financial reporting framework that has been applied in the preparation of the financial statements is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice), including FRS 101 Reduced Disclosure Framework.

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.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion, the information given in the Strategic Report and the Directors' Report for the year ended 31 December 2016 for the financial year for which the financial statements are prepared is consistent with the financial statements.

Other matters on which we are required to report by exception

Adequacy of accounting records and information and explanations received

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

- we have not received all the information and explanations we require for our audit; or
- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns.

We have no exceptions to report arising from this responsibility.

Directors' remuneration

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

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

Responsibilities for the financial statements and the audit

Our responsibilities and those of the directors

As explained more fully in the Statement of Directors' Responsibilities Statement set out on page 4, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view.

Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland) ("ISAs (UK & Ireland)"). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

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

What an audit of financial statements involves

We conducted our audit in accordance with ISAs (UK & Ireland). An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of:

- whether the accounting policies are appropriate to the company's circumstances and have been consistently applied and adequately disclosed;
- the reasonableness of significant accounting estimates made by the directors; and
- the overall presentation of the financial statements.

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

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

In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Mark Bolton (Partner)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London

Statement of Comprehensive Income
For the year ended 31 December 2016

	Notes	2016 £000	2015 £000
Revenue	4	37,924	35,151
Administrative expenses		<u>(37,010)</u>	<u>(33,539)</u>
Operating profit	5	914	1,612
Finance costs		<u>(22)</u>	<u>(16)</u>
Profit before taxation		892	1,596
Tax on profit	10	<u>(768)</u>	<u>(542)</u>
Profit and total comprehensive income for the year		<u>124</u>	<u>1,054</u>

All amounts reflect continuing operations.


The notes on pages 11 to 22 form part of these financial statements.

Statement of Financial Position
As at 31 December 2016

	Notes	2016 £000	2015 £000
Fixed assets			
Intangible assets	14	1,675	1,699
Property, plant and equipment	13	467	536
		2,142	2,235
Current assets			
Trade and other receivables	12	13,542	13,776
Prepayments		747	967
Cash and cash equivalents		1,045	159
Deferred tax	11	2,095	1,739
Current assets:		17,429	16,641
Creditors: amounts falling due within one year	15	7,389	5,504
Net current assets		10,040	11,137
Total assets less current liabilities		12,182	13,372
Net assets		12,182	13,372
Equity			
Called up share capital	16	5,000	5,000
Retained earnings		7,182	8,372
Total shareholders' funds		12,182	13,372

The notes on pages 11 to 22 are an integral part of these financial statements.

The financial statements on pages 8 to 22 were authorised for issue by the Board of Directors on August 2017 and were signed on its behalf by:


J. Kittinger
Finance Director

Statement of Changes in Equity
For the year ended 31 December 2016

	Notes	Called up share capital £000	Retained earnings £000	Total shareholders' funds £000
Balance at 1 January 2015		5,000	9,308	14,308
Profit and total comprehensive income for the year		-	1,054	1,054
Tax credit relating to share options		-	448	448
Share-based payments	9	-	1,562	1,562
Dividends	18	-	(4,000)	(4,000)
Balance at 31 December 2015		5,000	8,372	13,372
Profit and total comprehensive income for the year		-	124	124
Tax credit relating to share options		-	743	743
Share-based payments	9	-	1,943	1,943
Dividends	18	-	(4,000)	(4,000)
Balance at 31 December 2016		5,000	7,182	12,182

The notes on pages 11 to 22 form part of these financial statements.

Notes to the Financial Statements

1 General information

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

2 Summary of significant accounting policies

All accounting policies detailed below have been applied consistently.

(a) Basis of preparation

The Company has adopted Financial Reporting Standard 101, 'Reduced Disclosure Framework' (FRS 101). The financial statements of the Company have been prepared in accordance with FRS 101 and prepared under the historical cost convention.

The preparation of financial statements in conformity with FRS 101 requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Company's accounting policies. Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected.

The adoption of FRS 101 has not resulted in any impact on either profit or equity during the year.

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

The following exemptions from the requirements of IFRS have been applied in the preparation of these financial statements, in accordance with FRS 101:

- Paragraphs 45(b) and 46 to 52 of IFRS 2, 'Share-based payment' (details of the number and weighted-average exercise prices of share options, and how the fair value of goods or services received was determined)
- Paragraph 38 of IAS 1, 'Presentation of financial statements' comparative information requirements in respect of:
 - (i) paragraph 79(a)(iv) of IAS 1;
 - (ii) paragraph 73(e) of IAS 16 Property, plant and equipment;
 - (iii) paragraph 118(e) of IAS 38 Intangible assets (reconciliations between the carrying amount at the beginning and end of the period)
- The following paragraphs of IAS 1, 'Presentation of financial statements':
 - 10(d), (statement of cash flows),
 - 10(f) (a statement of financial position as at the beginning of the preceding period when an entity applies an accounting policy retrospectively or makes a retrospective restatement of items in its financial statements, or when it reclassifies items in its financial statements),
 - 16 (statement of compliance with all IFRS),
 - 38A (requirement for minimum of two primary statements, including cash flow statements),
 - 38B-D (additional comparative information),
 - 40A-D (requirements for a third statement of financial position),
 - 111 (cash flow statement information), and
 - 134-136 (capital management disclosures)
- IAS 7, 'Statement of cash flows'
- Paragraph 17 of IAS 24, 'Related party disclosures' (key management compensation)

Notes to the Financial Statements (*continued*)

2 Summary of significant accounting policies (*continued*)

(a) *Basis of preparation (continued)*

- The requirements in IAS 24, 'Related party disclosures' to disclose related party transactions entered into between two or more members of a group.

(b) *Going concern*

The Company meets its day-to-day working capital requirements through its cash reserves and borrowings. The current economic conditions continue to create uncertainty particularly over the level of demand for the Company's products. The Company's forecasts and projections, taking account of reasonably possible changes in trading performance, show that the Company should be able to operate within the level of its current cash reserves and borrowings. 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) *Management fees*

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

(d) *Functional currency*

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

(e) *Foreign currencies*

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

(f) *Cash and cash equivalents*

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

(g) *Trade and other receivables*

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

(h) *Creditors*

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

Notes to the Financial Statements (*continued*)

2 Summary of significant accounting policies (*continued*)

(i) *Current and deferred tax*

The tax expense for the period comprises current tax expense and deferred tax expense. Tax is recognised in the Statement of Comprehensive Income except to the extent that it relates to items recognised in other comprehensive income or directly in shareholders' funds, in which case the tax is recognised either in other comprehensive income or directly in shareholders' funds, as the case may be.

The current income tax expense is calculated using the tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period in the countries where the company operates and generates taxable income. Management periodically evaluates the positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation and, where appropriate, establishes provisions on the basis of amounts expected to be paid to the relevant tax authorities.

Current income tax is the expected tax payable or recoverable on the taxable profit or loss for the year, plus any adjustment to tax payable in respect of previous periods, net of any amounts already paid in respect of current and prior periods.

Deferred tax is recognised on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. However, deferred tax liabilities are not recognised if they arise from the initial recognition of goodwill; or if they arise from the initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss.

Deferred tax is calculated using the tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period and that are expected to apply to the period when the asset is realised or the liability is settled. Deferred tax assets and liabilities are not discounted.

Deferred tax assets are recognised only to the extent that it is probable that future taxable profit will be available against which the deductible temporary differences can be utilised.

Deferred tax assets and liabilities are offset if there is a legally enforceable right to set off current income tax assets against current income tax liabilities and if they relate to income taxes levied by the same taxation authority on the same taxable entity.

Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

(j) *Property, plant and equipment*

(i) *Recognition and measurement*

Items of property, plant and is stated at historical cost less depreciation. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

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

(ii) *Subsequent costs*

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

Notes to the Financial Statements (continued)

2 Summary of significant accounting policies (continued)

(j) Property, plant and equipment (continued)

(iii) Depreciation

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

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

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

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

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

(k) Intangible assets

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

(l) Pension costs

All employees are eligible to become members of a defined contribution Group Personal Pension Plan. The assets of the scheme are held separately from those of the Company in an independently administered fund.

The amount charged to the Statement of Comprehensive Income represents the contributions payable to the scheme in respect of the accounting year.

(m) Leases

Rentals payable under operating leases are charged to the Statement of Comprehensive Income in equal annual instalments over the period of the lease.

(n) Share-based payments

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

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

(o) Share capital

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

Notes to the Financial Statements (continued)

2 Summary of significant accounting policies (continued)

(p) Provisions

Provisions are provided for where there is a present obligation as a result of a past event, that can be measured reliably and it is probable that an outflow of economic benefits will be required to settle that obligation. Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognised as interest expense.

(q) Dividend distribution

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

3 Critical accounting estimates and judgments

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

Useful economic lives of property, plant and equipment

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

4 Revenue

	2016 £000	2015 £000
Management fees	37,924	35,151

5 Operating Profit

	2016 £000	2015 £000
Operating profit is arrived at after charging:		
Depreciation	89	179
Amortisation	562	504
Operating lease rentals:		
- Land and buildings	1,012	1,165

Notes to the Financial Statements (continued)

6 Auditors' Remuneration

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

	2016 £000	2015 £000
Fees payable to the Company's auditors and their Associates for the audit of the Company's annual financial statements	37	41
Fees payable to the Company's auditors and their associates for other services:		
- Tax advisory services	-	20
- Other non-audit services	-	-
	<u>37</u>	<u>61</u>

7 Directors and Employees Costs

(a) Directors' remuneration

All staff costs are recharged to either the parent company or fellow subsidiary companies. There were no transactions between the Company and its Directors and Officers during the year ended 31 December 2016 which require disclosure.

	2016 £000	2015 £000
Directors' emoluments		
Aggregate emoluments	1,605	1,696
Amounts receivable under long-term incentive schemes	-	100
Company pension contributions to money purchase schemes	28	71
Compensation for loss of office	958	-
 Highest paid director (included above)		
Aggregate of emoluments and awards under long-term incentive schemes, including £nil (2015: £5k) in pension contributions	539	582
 Number of directors who received shares in ACGL	2	5
Number of directors participating in money purchase scheme	2	3
Number of directors who exercised share options	3	4

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

Notes to the Financial Statements (continued)

7 Directors and Employees Costs (continued)

(b) Staff Costs

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

	2016 Number	2015 Number
Underwriting	67	55
Administration and Finance	55	59
Claims	19	19
	<u>141</u>	<u>133</u>

	2016 £000	2015 £000
The aggregate payroll costs of these persons were as follows:		
- Wages and salaries	12,277	10,366
- Social security costs	2,392	2,028
- Other pension costs	1,320	1,739
- Share-based payments	<u>1,943</u>	<u>1,564</u>
	<u>17,932</u>	<u>15,697</u>

8 Pensions

The Company contributes to a defined contribution Group Personal Pension Plan. The assets of the scheme are held separately from those of the Company in an independently administered fund. The unpaid contributions outstanding at the end of the year were nil (2015: nil).

9 Share-Based Payments

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

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

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

The share awards outstanding at 31 December 2016 have an exercise price in the range of \$19.29 to \$71.70 (2015: \$14.75 to \$62.51) and a weighted average contractual life of 4.90 years (2015: 5.67 years).

The weighted average share price at the date of exercise for share awards exercised in 2016 was \$75.22 (2015: \$62.84).

The charge to the statement of comprehensive income in respect of share-based payments and the corresponding credit to equity was £1,942,763 (2015: £1,563,649).

Notes to the Financial Statements (continued)

10 Tax on profit

Tax charged in the statement of comprehensive income comprises the following:	2016	2015
	£000	£000
Current tax:		
- UK corporation tax on profits for the year	48	231
- Transfer from equity on share-based payments	206	266
- Adjustments in respect of prior years	333	2
Total current tax	587	499
Deferred tax (note 11):		
- Origination and reversal of temporary differences	(648)	(274)
- Adjustments in respect of prior years	(78)	141
- Transfer from equity on share-based payments	640	182
- Impact of change in UK tax rate	267	(6)
Total deferred tax	181	43
Tax expense reported in the statement of comprehensive income	768	542

Tax recognised directly in equity comprises the following:	2016	2015
	£000	£000
Current tax credit on share-based payments	(206)	(266)
Deferred tax credit on share-based payments	(640)	(182)
Impact of change in UK tax rate	103	-
Tax income recognised directly in equity	(743)	(448)

Reconciliation of tax expense

The tax assessed for the year ended 31 December 2016 is higher (2015: higher) than the standard rate of corporation tax in the UK.

The differences are explained as follows:

	2016	2015
	£000	£000
Profit before taxation	892	1,596
Profit multiplied by the standard rate of tax in the UK of 20.00% (2015: 20.25%)	178	323
Effects of:		
- Expenses not deductible for tax purposes	68	88
- Impact of change in UK tax rate	267	(6)
- Adjustments in respect of prior years	255	143
- Permanent difference on share options and restricted stock	(846)	(454)
- Transfer to equity on employee share schemes	846	448
Tax expense reported in the statement of comprehensive income	768	542

Notes to the Financial Statements (continued)

10 Income tax expense (continued)

The standard rate of corporation tax in the UK throughout the year ended 31 December 2016 was 20%. As a consequence the Company's profits for this period are taxed at an effective rate of 20.00% (2015: 20.25%).

The calculation of taxes outstanding at the end of the reporting period takes into account the reductions in the standard rate of UK corporation tax from 20% to 19% (effective from 1 April 2017) and then to 17% (effective from 1 April 2020). These rate changes were enacted by Finance (No. 2) Act 2015 on 18 November 2015 and Finance Act 2016 on 15 September 2016 respectively.

11 Deferred Tax

Deferred tax assets and liabilities are attributable to the following:

	Statement of Financial Position		Statement of Comprehensive Income	
	2016 £000	2015 £000	2016 £000	2015 £000
Fixed asset temporary differences	178	173	(5)	(111)
Share-based payments	1,840	1,481	178	2
Pension accruals	-	-	-	1
Other	77	85	8	151
Deferred tax expense (note 10)			181	43
Net deferred tax assets	2,095	1,739		

Reflected in the Statement of Financial Position as follows:

Deferred tax assets	2,095	1,739
Deferred tax liabilities	-	-
Net deferred tax assets	2,095	1,739

Reconciliation of net deferred tax asset	2016 £000	2015 £000
Deferred tax as at 1 January	1,739	1,600
Deferred tax expense in the period recognised in profit and loss	(181)	(43)
Deferred tax income in the period recognised directly in equity	537	182
Deferred tax as at 31 December	2,095	1,739

The deferred tax asset is likely to be realised beyond twelve months as the temporary differences reverse.

12 Trade and Other Receivables

	2016 £000	2015 £000
Due within one year:		
Amounts owed from group undertakings	13,142	13,291
Other	400	485
	13,542	13,776

Notes to the Financial Statements (continued)

13 Property, Plant and Equipment

	Leasehold improvements	Furniture and Fixtures	Other computer Hardware	Total
	£000	£000	£000	£000
Book cost:				
At 1 January 2016	440	353	409	1,202
Additions	5	-	16	21
Transfers	-	6	297	303
At 31 December 2016	445	359	722	1,526
Accumulated depreciation:				
At 1 January 2016	39	256	371	666
Charge for the year	39	25	25	89
Transfers	-	7	297	304
At 31 December 2016	78	288	693	1,059
Net book value:				
31 December 2016	367	71	29	467
31 December 2015	401	97	38	536

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

14 Intangible Assets

	Computer software under service contract	Total
	£000	£000
Book cost:		
At 1 January 2016	4,446	4,446
Additions	538	538
Transfers	1,349	1,349
At 31 December 2016	6,333	6,333
Accumulated amortisation:		
At 1 January 2016	2,747	2,747
Charge for the year	562	562
Transfers	1,349	1,349
At 31 December 2016	4,658	4,658
Net book value:		
31 December 2016	1,675	1,675
31 December 2015	1,699	1,699

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

Notes to the Financial Statements (continued)

15 Creditors: amounts falling due within one year

	2016	2015
	£000	£000
Amounts falling due within one year:		
Other creditors	50	56
Amounts owed to related parties	825	-
Current tax liability	48	733
Accrued expenses and deferred income	6,466	4,715
	<u>7,389</u>	<u>5,504</u>

16 Called Up Share Capital

	2016	2015
	£000	£000
<i>Issued and fully paid</i>		
5,000,000 (2015: 5,000,000) Ordinary shares of £1 each	<u>5,000</u>	<u>5,000</u>

17 Operating Lease Arrangements

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

	2016	2015
	£000	£000
Within one year	1,332	1,299
In the second to fifth years inclusive	4,207	4,515
	<u>5,539</u>	<u>5,814</u>

18 Dividends

The following table shows the dividends paid to equity shareholders:

	2016		2015	
	Pence (per ordinary share)	Dividend Paid £000	Pence (per ordinary share)	Dividend paid £000
Interim dividend for the year	80	4,000	80	4,000
	<u>80</u>	<u>4,000</u>	<u>80</u>	<u>4,000</u>

19 Parent Company

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

The smallest and largest group in which the results of the Company are consolidated is that headed by ACGL. The consolidated financial statements of ACGL are available to the public and may be obtained from Arch Capital Group Ltd, Waterloo House, Ground Floor, 100 Pitts Bay Road, Pembroke HM 08, Bermuda.

Notes to the Financial Statements *(continued)*

20 Related Party Transactions

Key management personnel and director transactions

There were no transactions between the Company and its Directors and Officers during the year ended 31 December 2016 which require disclosure other than those detailed in note 7.

Other related party transactions

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

Directors and Administration

Directors

J. Kittinger
M. Shulman
B. Singh

Company Secretary

TMF Corporate Secretarial Services Limited

Registered Number

06645619

Registered Office

5th Floor
Plantation Place South
60 Great Tower Street
London
EC3R 5AZ

Independent Auditors

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

Principal Bankers

Barclays Bank Plc, London

Website

www.archinsurance.co.uk