

THE UNITED KINGDOM DEFENCE INSURANCE
ASSOCIATION (ISLE OF MAN) LIMITED

FINANCIAL STRENGTH

*The United Kingdom Defence Insurance Association (Isle of Man) Limited,
Directors' Report and Financial Statements for the year ended 20 February 2014*



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DIRECTORS, OFFICERS AND MANAGERS

Directors

Dr. D. L. Moore
E. Shallcross
P. Gruaz (resigned 10 April 2013)
K.L. Marshall
I.R. Jarrett
Y. Botonakis

Manager

Thomas Miller (Isle of Man) Limited
Level 2
Samuel Harris House
5-11 St Georges Street
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Secretary

Havelock Insurance Management Limited
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Investment Manager

Thomas Miller Investment (Isle of Man) Limited
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5-11 St Georges Street
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IM1 1AJ

Registered Office

Level 2
Samuel Harris House
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DIRECTORS' REPORT

The Directors have pleasure in presenting their Report and the Financial Statements of the Association for the year ended 20 February 2014.

Principal activity

Under an agreement dated 19 February 1999, the Association reinsures 90 per cent of the business of The United Kingdom Freight Demurrage and Defence Association Limited ("UKFD&D").

UKFD&D carries on the business of mutual insurance of its Members against legal costs and expenses as defined in its Rules of the Association.

Directors

The Directors of the Association who served during the year and to date are shown on page 2.

Review of the year

Operations for the year resulted in a profit of £4,458,000 (2013: loss of £3,255,000).

The Association is exposed to financial risk through its financial assets and liabilities.

The key financial risk is that the proceeds from financial assets are not sufficient to fund the obligations arising from liabilities as they fall due. The most important components of financial risk are: market risk, credit risk, insurance risk and liquidity risk.

Market risk

Market risk is the risk of adverse financial impact due to changes in fair values or future cash flows of financial instruments from fluctuations in interest rates, equity prices and foreign exchange rates, affecting both the value of the Association's investments and, in the case of exchange rates, its premium income and liabilities. The Association has a policy in place to manage its exposure to its investments, and this is monitored by regular reports from the investment managers to the Association's Board of Directors.

The impact of exchange rate risk is mitigated by the use of forward contracts for the sale of premium income, which is almost all received in US dollars, into sterling, and the currency matching of assets and liabilities.

Credit risk

The key areas where the Association is exposed to Credit risk, which is the risk that a counterparty will be unable to pay amounts in full when due, are

- Amounts due from UKFD&D
- Counterparty risk with respect to cash and investments

Insurance risk

The Association's risk can arise from:

- a) fluctuation in the timing, frequency and severity of claims and claims settlements relative to expectations;
- b) unexpected claims arising from single source;
- c) inaccurate pricing of risks when underwritten;
- d) inadequate reinsurance protection;
- e) inadequate reserves.

The risk is managed by underwriting, reinsurance and reserving strategies which are agreed and monitored by the Association's Board.

Liquidity risk

The Association manages this risk by the use of liquid investments.

The Directors are responsible for preparing the 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, which meet the requirements of Isle of Man company law. In addition, the Directors have elected to prepare the financial statements in accordance with UK Accounting Standards.

The financial statements are required by law to 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 estimates that are reasonable and prudent;
- state whether they have been prepared in accordance with UK Accounting Standards; 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 proper 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 to enable them to ensure that the financial statements comply with the Companies Acts 1931 to 2004 as modified by the Insurance Act 2008. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Company and to prevent and detect fraud and other irregularities.

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation governing the preparation and dissemination of financial statements may differ from one jurisdiction to another.

Auditors

KPMG Audit LLC, being eligible, has indicated its willingness to continue in office in accordance with Section 12(2) of the Isle of Man Companies Act 1982.

By Order of the Board
K.H.B. Allen

For and on behalf of
Havelock Insurance Management Limited

Secretary
15 April 2014

INDEPENDENT AUDITOR'S REPORT

Report of the independent auditor's, KPMG Audit LLC, to the members of the United Kingdom Defence Insurance Association (Isle of Man) Limited

We have audited the financial statements of The United Kingdom Defence Insurance Association (Isle of Man) Limited for the year ended 20 February 2014 which comprise the Income and Expenditure Account, Balance Sheet, Cash Flow Statement and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and UK Accounting Standards.

This report is made solely to the Company's members, as a body, in accordance with Section 15 of the Companies Act 1982. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditor

As explained more fully in the Directors' Responsibilities Statement set out on page 3,4 and 5, the Directors are responsible for the preparation of financial statements that 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). Those standards require us to comply with the Auditing Practices Board's (APB's) Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Directors; and the overall presentation of the financial statements.

In our opinion the financial statements:

- give a true and fair view of the state of the Company's affairs as at 20 February 2014 and of its profit for the year ended;
- have been properly prepared in accordance with UK Accounting Standards; and
- have been properly prepared in accordance with the provisions of Companies Acts 1931 to 2004 as modified by the Insurance Act 2008.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Acts 1931 to 2004 as modified by the Insurance Act 2008 require us to report to you if, in our opinion:

- proper books of account have not been kept and proper returns adequate for our audit have not been received from branches not visited by us; or
- the Company's Balance Sheet and Income and Expenditure Account are not in agreement with the books of account and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

KPMG Audit LLC

Chartered Accountants
Heritage Court
41 Athol Street
Douglas
Isle of Man IM99 1HN
15 April 2014

INCOME AND EXPENDITURE ACCOUNT

For the year ended 20 February 2014

| | Notes | | 2014 £'000 | 2013 £'000 |
|--|-------|----------|---------------|----------------|
| Premiums | | | | |
| Premiums receivable | 2a | | 10,359 | 7,349 |
| Investment Return | | | | |
| Investment income | 2f, 4 | 1,132 | | 811 |
| Gains on investments | | | | |
| Realised | | 630 | | 217 |
| Unrealised | | (951) | | 1,167 |
| | | | 811 | 2,195 |
| Claims | | | | |
| Claims paid less recoveries | 2b | (10,730) | | (10,146) |
| Change in provision for outstanding claims | | 4,351 | | (2,405) |
| | | | (6,379) | (12,551) |
| Expenses | | | | |
| Management fee | 6 | (270) | | (171) |
| General and administrative expenses | 5 | (63) | | (66) |
| | | | (333) | (237) |
| Foreign exchange losses | 2c | | - | (11) |
| Profit/(loss) for the year | | | 4,458 | (3,255) |

The notes on pages 11 to 16 form an integral part of these Financial Statements.

The Association has no recognised gains or losses other than those dealt with in the Income and Expenditure Account.

The Directors consider that the above results derive from continuing activity.

BALANCE SHEET

At 20 February 2014

| | Notes | 2014 £'000 | 2013 £'000 |
|-----------------------------------|-------|-----------------|-----------------|
| Assets | | | |
| Investments | 2e,7 | 46,764 | 49,139 |
| Cash balances | 2g | 976 | 103 |
| Total cash and investments | | 47,740 | 49,242 |
| Accrued interest | | 165 | 193 |
| Prepaid expenses | | 6 | 6 |
| Total assets | | 47,911 | 49,441 |
| Liabilities | | | |
| Outstanding claims | 8 | (24,980) | (29,331) |
| Related party balances | 12 | (423) | (2,052) |
| ITIP payable | | - | (1) |
| Accrued expenses | | (17) | (24) |
| Total liabilities | | (25,420) | (31,408) |
| Net Assets | | 22,491 | 18,033 |
| Reserves | | | |
| Guarantee fund | 9 | 100 | 100 |
| Retained earnings | 9 | 22,391 | 17,933 |
| Total reserves | | 22,491 | 18,033 |

Directors

Dr D.L. Moore
E. Shallcross

15 April 2014

Managers

K.H.B. Allen
For and on behalf of Thomas Miller
(Isle of Man) Limited

The notes on pages 11 to 16 form an integral part of these Financial Statements.

CASH FLOW STATEMENT

For the year ended 20 February 2014

| | 2014 £'000 | 2013 £'000 |
|---|----------------|----------------|
| Cash flow statement | | |
| Premiums received | 10,359 | 7,349 |
| Claims paid | (12,359) | (6,348) |
| Management fee, general and administration expenses | (341) | (250) |
| Interest received and exchange gain | 1,160 | 864 |
| Net cash flow from operating activities | (1,181) | 1,615 |
| Investment purchases | (38,280) | (40,358) |
| Investment sales | 40,334 | 38,672 |
| Net cash flow from investing activities | 2,054 | (1,686) |
| Net increase / (decrease) in cash and cash equivalents | 873 | (71) |
| Operating activities | | |
| Balance on Income and Expenditure Account | 4,458 | (3,255) |
| Profit on disposal of investments | (630) | (217) |
| Unrealised investment loss/(gain) | 951 | (1,167) |
| (Decrease) / increase in claims provision | (4,351) | 2,405 |
| Decrease in accrued interest and prepaid expenses | 28 | 65 |
| Decrease in accrued expenses | (8) | (14) |
| (Decrease) / increase in related party balances | (1,629) | 3,798 |
| Net cash flow from operating activities | (1,181) | 1,615 |

The notes on pages 11 to 16 form an integral part of these Financial Statements.

1. Constitution

The Association was incorporated in the Isle of Man on 9 February 1999 and received authorisation from the Isle of Man Government Insurance and Pensions Authority to carry on an insurance business in or from the Isle of Man on 17 February 1999.

The Association is limited by guarantee and its Members undertake to contribute such amounts as may be required, not exceeding one pound sterling.

The Directors have the right to make supplementary calls on the Members (see note 12) for any open policy year to make good any deficit of income on that year, and similarly may return any surplus arising on a year to the Members.

The Association assumes 90% of the retained legal costs and expenses insurance risks of The United Kingdom Freight Demurrage and Defence Association Limited ("UKFD&D") as set out in the reinsurance agreement. UKFD&D is a UK based insurance company, related through common membership.

In the event of the Association's liquidation the net assets of the Association are to be distributed in proportion to the amount of contributions paid by Members to UKFD&D during the period of six years preceding the commencement of the winding-up.

2. Accounting policies

These Financial Statements are prepared in accordance with United Kingdom Accounting Standards.

Significant accounting policies are:

a) Premiums

Premiums are recorded on an accruals basis. The Association has the ability to make supplementary calls upon Members. These calls and premiums are the total receivable for the whole period of cover provided by the contracts incepting during the accounting period together with any adjustments in respect of prior accounting periods. There are no unearned premiums.

The reinsurance agreement with UKFD&D contains provisions with respect to premium adjustments. The adjustments are dependent upon the invested assets of one party as a proportion of the total of both parties and may be made by either UKFD&D or the Association. Any such premium adjustments are recorded in the Financial Statements in the accounting period in which they are made.

b) Claims

Claims are recorded on a reported basis. In addition, provision is made for claims incurred but not reported based on information provided to the Association by its reinsured and the estimates of the Managers.

The setting of reserves is a complex process and is inherently uncertain and whilst the Directors consider that the gross provisions for claims are fairly stated on the basis of information currently available, the ultimate liability will vary as a result of subsequent information and events and may result in significant adjustments to the amount provided. Any differences between the provisions and subsequent settlements are recorded in the Income and Expenditure Account of later years.

c) Foreign currencies

Revenue transactions in foreign currencies have been translated into sterling at rates revised at monthly intervals. All exchange gains and losses whether realised or unrealised are included in the Income and Expenditure Account. The differences arising on currency translation and the realised differences arising on the sale of currencies are included within realised gains within investment income.

Foreign currency assets and liabilities including investments are carried at market value translated into sterling at the rates of exchange ruling at the Balance Sheet date. The resulting difference is treated as unrealised.

d) Expenses

Commission payable, management fees and other general and administrative expenses are recorded on an accruals basis.

e) Investments

Investments consist of bond securities, Undertakings for Collective Investments of Transferable Securities ("UCITS") and holdings in listed and unlisted funds. Bond securities consist of government stocks, unit trusts and corporate bonds. UCITS are used as an alternative to cash deposits.

Bonds and UCITS investments are stated at their market value as at the Balance Sheet date using bid prices. Listed funds consist of Absolute Return Funds which are carried at the latest published Net Asset Value within 3 months of the Balance Sheet date. Unlisted funds comprise of a holding in the "TMI Income Fund", which is carried at the most recently available Net Asset Value.

Investments purchased in foreign currencies are translated into sterling on the date of purchase. The market values of foreign currency investments are translated at the rate of exchange ruling at the Balance Sheet date.

f) Investment income

The interest receivable from the investments together with the profits and losses on sale of investments are included within investment income in the Income and Expenditure Account. The unrealised gains and losses on the movement in the market value of the investments compared to the cost are included in unrealised gains and losses on investments in the Income and Expenditure Account. Cost is recorded using the weighted average basis.

g) Cash and cash equivalents

Cash and cash equivalents are defined as cash in hand, demand deposits and short-term, highly liquid investments which are readily convertible to known amounts of cash and subject to insignificant risk of changes in value and are subsequently measured at cost as they have a short-term maturity.

The Association is required by the Isle of Man Government Insurance and Pensions Authority to hold £100,000 with a bank licensed under the provisions of the Isle of Man Banking Acts, 1998.

3. Taxation

The income of the Association is subject to Manx Income Tax at the rate of 0% (2013: 0%).

4. Investment income

| | 2014 £'000 | 2013 £'000 |
|--------------------------------------|---------------|---------------|
| Bond interest | 774 | 753 |
| Bank deposit interest | 12 | 35 |
| Currency gains | 354 | 62 |
| Custody and investment managers fees | (8) | (39) |
| Investment income | 1,132 | 811 |

5. General and administrative expenses

| | 2014 £'000 | 2013 £'000 |
|---|---------------|---------------|
| Audit fees | 16 | 18 |
| Directors' fees | 17 | 20 |
| Directors' and officers' insurance | 9 | 9 |
| Directors' and managers' travel | 14 | 7 |
| Government fees | 5 | 5 |
| Professional fees | - | 5 |
| Printing, stationery and communications | 1 | 1 |
| Sundry costs | 1 | 1 |
| | 63 | 66 |

6. Management Fee

The fee paid to the Managers of £270,000 (2013: £171,000) covers the cost of providing insurance management services, offices, staff and administration in the Isle of Man, and includes investment management services provided by a company in the same group as the Managers. Included in Note 4 within Custody fees and investment managers fees is an additional amount of nil (2013: £33,000) in respect of investment management services provided by the Managers.

7. Investments

| | Cost 2014 £'000 | Market Value 2014 £'000 | Cost 2013 £'000 | Market Value 2013 £'000 |
|--------------------------------|--------------------------------|--|--------------------------------|--|
| Government and corporate bonds | 28,602 | 28,235 | 25,447 | 25,773 |
| Equities | 6,373 | 7,421 | 6,093 | 7,275 |
| Absolute return funds | 4,427 | 4,705 | 5,560 | 5,840 |
| UCITS | 5,192 | 5,096 | 8,918 | 8,932 |
| TMI Income Fund | 1,250 | 1,307 | 1,250 | 1,319 |
| Total investments | 45,844 | 46,764 | 47,268 | 49,139 |

8. Outstanding claims

The provision for outstanding claims consists of the estimated cost of known outstanding claims, together with a forecast of claims incurred but not reported, on risks already written.

| | 2014 £'000 | 2013 £'000 |
|----------------|-----------------------|-----------------------|
| Policy year | | |
| 2013 | 9,266 | - |
| 2012 | 5,460 | 10,219 |
| 2011 | 3,797 | 7,881 |
| 2010 | 2,054 | 4,228 |
| 2009 | 1,218 | 2,143 |
| 2008 and prior | 3,185 | 4,860 |
| | 24,980 | 29,331 |

The total of outstanding claims of £24,980,000 consists of a forecast of unreported claims of £19,789,000 and an estimate of known claims of £5,191,000.

9. Reserves

| | Guarantee fund £'000 | Retained earnings £'000 | Total £'000 |
|-------------------------------|-------------------------------------|--|------------------------|
| As at 20 February 2013 | 100 | 17,933 | 18,033 |
| Transfer during the year | - | 4,458 | 4,458 |
| As at 20 February 2014 | 100 | 22,391 | 22,491 |

The Association's regulator is the Isle of Man Insurance and Pensions Authority ("IPA") in the Isle of Man. Under the IPA's regime the Association is obliged to assess and maintain the amount of net assets in excess of the required minimum solvency margin. The provisions of the Isle of Man Insurance Regulations 1986 set the minimum level of solvency required of the Association in the Isle of Man. The premium solvency margin required for 2014 was £941,650 (2013: £770,550).

At the year end the Association's capital resources included reserves of £22,491,000 (2013: £18,033,000) which exceeded the minimum solvency requirement by £21,549,350 (2013: £17,262,450). The Association, therefore, complied with the externally imposed capital requirements to which it is subject.

The Guarantee Fund represents the initial capital as required by the Isle of Man Insurance and Pensions Authority.

10. Debenture

The Association has charged by debenture certain liabilities to UKFD&D, to whom the Association provides reinsurance. The Association has covenanted to discharge the following liabilities:-

1. The Association's liabilities to UKFD&D including those under the reinsurance agreement
2. Any amount necessary to enable UKFD&D to meet its solvency margin, and
3. Any expenses incurred by UKFD&D relating to enforcing or exercising any power under the debenture.

The debenture is secured by floating charge over the Association's assets but excludes £1,100,000, this amount being sufficient to meet the solvency requirements of the Isle of Man Government Insurance and Pensions Authority.

11. Exchange rates

| | 2014 | 2013 |
|---|--------|--------|
| As at the Balance Sheet date, £1 equals | | |
| US dollar | 1.6659 | 1.5443 |
| Euro | 1.2149 | 1.1563 |

12. Related party disclosures and ultimate controlling parties

The Association has no share capital and is controlled by the Members. A Member is any person to whom UKFD&D has afforded primary insurance which is subsequently reinsured into the Association. Members of the Association are therefore also Members of UKFD&D, under that Association's rules. At the balance sheet date there were over 2,000 Members and therefore, no one Member is able to assert significant control.

The Association's principal activity is the business of an insurance company providing reinsurance cover to an entity under common control. Consequently, insurance premiums written and received and, claims and commission paid and provided for are considered to be related party transactions in accordance with Financial Reporting Standard No.8.

At 20 February 2014 £373,000 was due to UKFD&D (2013: £2,002,000).

At 20 February 2014, £50,000 was due to The United Kingdom Defence Reinsurance Association Limited ("UKDRA") (2013: £50,000). There was no movement in the balance during the year. UKDRA is a wholly owned subsidiary of UKFD&D.

Mr P. Gruaz who served as a Director for part of the year, was an employee of a Member company. Other than the insurance and membership interests of the Member company, Mr P Gruaz had no financial interest in the Association. The amounts paid to Directors during the year are detailed in Note 5.

Mr I R Jarrett was also a Director of the Managers, Thomas Miller (Isle of Man) Limited during the year. See also Note 6.

The investment services are sub-contracted by the Managers to Thomas Miller Investment (Isle of Man) Limited who are in the same group as the Managers.

All transactions were conducted on an arm's length basis.





Strength with independence.

UKDIA

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Registered in the Isle of Man
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