

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

ABOVE & BEYOND

*The United Kingdom Defence Insurance Association (Isle of Man) Limited,
Directors' Report and Financial Statements for the year ended 20 February 2016*

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DIRECTORS, OFFICERS AND MANAGERS

Directors

Dr. D. L. Moore
E. Shallcross
K.L. Marshall
I.R. Jarrett
Y. Botonakis
G Panayides

Manager

Thomas Miller (Isle of Man) Limited
Level 2
Samuel Harris House
5-11 St Georges Street
Douglas
Isle of Man
IM1 1AJ

Secretary

Thomas Miller (Isle of Man) Limited (appointed 23 April 2014)
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Samuel Harris House
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IM1 1AJ

Investment Manager

Thomas Miller Investment (Isle of Man) Limited
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Registered Office

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The Directors have pleasure in presenting their Report and the Financial Statements of the Association for the year ended 20 February 2016.

Principal activity

Under a revised agreement dated 31 December 2015, 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 loss of £117,000 (2015: profit of £2,706,000).

Transition to FRS 102

This is the first year that the Association has presented its results under FRS 102 'The Financial Reporting Standard, applicable in the UK and Republic of Ireland' as applicable to an Isle of Man company. The last financial statements under previous UK GAAP were for the year ended 20 February 2015. In accordance with FRS 102, the Association has accounted for insurance contracts in accordance with FRS 103 'Insurance Contracts'. The impact of the transition to FRS 102 is set out in Note 14 'Explanation of transition to FRS 102'.

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 as applicable to an Isle of Man Company.

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 as applicable to an Isle of Man company; 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.

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

For and on behalf of
Thomas Miller (Isle of Man) Limited

Company Secretary
26 April 2016

Report of the independent auditor 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 2016 which comprise the Income and Expenditure Account, Balance Sheet, Statement of Changes in Reserves, 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 including FRS102 the Financial Reporting Standard applicable in the UK and Republic of Ireland as applicable to an Isle of Man company.

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 2 and 3, 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 addition, we read all the financial and non-financial information in the Directors' 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 became aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on 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 2016 and of its loss for the year ended;
- have been properly prepared in accordance with UK Accounting Standards as applicable to an Isle of Man company; 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

26 April 2016

INCOME AND EXPENDITURE ACCOUNT

For the year ended 20 February 2016

| | Notes | | 2016 £'000 | 2015 £'000 |
|--|-------|---------|---------------|---------------|
| Premiums | | | | |
| | 2d | | | |
| Premiums receivable | | 15,498 | | 15,696 |
| Agreed discount | | (5,957) | | (5,566) |
| | | | 9,541 | 10,130 |
| Claims | | | | |
| | 2e | | | |
| Claims paid less recoveries | | (9,280) | | (8,533) |
| Change in provision for outstanding claims | | (277) | | (363) |
| | | | (9,557) | (8,896) |
| Investment Return | | | | |
| Investment income | 2f, 6 | 1,809 | | 843 |
| Gains / (Losses) on investments | | | | |
| Realised | | 581 | | 633 |
| Unrealised | | (2,140) | | 323 |
| | | | 250 | 1,799 |
| Expenses | | | | |
| | 2g | | | |
| Management fee | 8 | (272) | | (265) |
| General and administrative expenses | 7 | (79) | | (62) |
| | | | (351) | (327) |
| (Loss) / Profit for the year | | | (117) | 2,706 |

The notes on pages 11 to 23 form an integral part of these Financial Statements.
The Directors consider that the above results derive from continuing activities.

BALANCE SHEET

At 20 February 2016

| | Notes | 2016 £'000 | 2015 £'000 |
|----------------------------------|-------|-----------------|-----------------|
| Assets | | | |
| Investments | 9 | 50,013 | 51,868 |
| Derivative financial investments | 10 | 70 | 154 |
| Due from investment brokers | | 1,633 | - |
| Cash and cash equivalents | | 511 | 180 |
| Accrued interest | | 71 | 92 |
| Prepaid expenses | | 6 | 6 |
| Total assets | | 52,304 | 52,300 |
| Liabilities | | | |
| Technical provisions | 12 | (25,620) | (25,343) |
| Derivative financial instruments | 10 | (14) | (136) |
| Due to investment brokers | | (258) | - |
| Related party balances | 13 | (1,310) | (1,605) |
| Accrued expenses | | (22) | (19) |
| Total liabilities | | (27,224) | (27,103) |
| Net Assets | | 25,080 | 25,197 |
| Reserves | | | |
| Guarantee fund | | 100 | 100 |
| Income and Expenditure Account | | 24,980 | 25,097 |
| Total reserves | | 25,080 | 25,197 |

These financial statements were approved by the directors on 26 April 2016.

Directors

Dr D.L. Moore
E. Shallcross

Managers

K.H.B. Allen
Thomas Miller (Isle of Man) Limited

The notes on pages 11 to 23 form an integral part of these Financial Statements.

STATEMENT OF CHANGES IN RESERVES

For the year ended 20 February 2016

| | Guarantee Fund £'000 | Income and Expenditure Account £'000 | Total £'000 |
|------------------------------------|-------------------------|---|----------------|
| Balance at 20 February 2014 | 100 | 22,391 | 22,491 |
| Profit for the year | - | 2,706 | 2,706 |
| Balance at 20 February 2015 | 100 | 25,097 | 25,197 |
| Balance at 20 February 2015 | 100 | 25,097 | 25,197 |
| Loss for the year | - | (117) | (117) |
| Balance at 20 February 2016 | 100 | 24,980 | 25,080 |

The notes on pages 11 to 23 form an integral part of these Financial Statements.

CASH FLOW STATEMENT

For the year ended 20 February 2016

| | 2016 £'000 | 2015 £'000 |
|---|----------------|----------------|
| Operating activities | | |
| Premiums received | 9,541 | 10,130 |
| Claims paid | (9,575) | (7,351) |
| Management fee, general and administration expenses | (348) | (325) |
| Interest received and exchange gain | 1,830 | 917 |
| Net cash inflow from operating activities | 1,448 | 3,371 |
| Investment activities | | |
| Investment purchases | (67,877) | (78,898) |
| Investment sales | 66,760 | 74,731 |
| Net cash outflow from investing activities | (1,117) | (4,167) |
| Net increase / (decrease) in cash and cash equivalents | 331 | (796) |
| Cash and cash equivalents at 21 February | 180 | 976 |
| Cash and cash equivalents at 20 February | 511 | 180 |
| Reconciliation of loss/profit to net cash flow from operating activities | | |
| (Loss) / profit for the year | (117) | 2,706 |
| Realised gains on investments | (581) | (633) |
| Unrealised investment loss / (gain) | 2,140 | (323) |
| Increase in claims provision | 277 | 363 |
| Decrease in accrued interest and prepaid expenses | 21 | 74 |
| Increase in accrued expenses | 3 | 2 |
| (Decrease) / increase in related party balances | (295) | 1,182 |
| Net cash flow from operating activities | 1,448 | 3,371 |

The notes on pages 11 to 23 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 Financial Services Authority ('IOMFSA') 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 (see also note 14). In accordance with the Association's Rules the Directors have the right to make special calls on Members, who had a Reinsured Entry in the current policy year and previous 4 policy years, to make good any deficit of income. Similarly, the Directors may return any surplus 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

a) Accounting disclosures

The financial statements have been prepared in accordance with United Kingdom accounting standards as applicable to an Isle of Man company. The financial statements are prepared on an annual basis under the historical cost convention as modified to include certain items at fair value, and in accordance with Financial Reporting Standard ("FRS") 102 issued by the Financial Reporting Council. In addition, all insurance balances have been accounted for under the requirements of FRS 103 'Insurance contracts'.

The prior year financial statements were restated for material adjustments on adoption of FRS 102 in the current year. For more information see note 14.

The functional currency of the Association is considered to be pounds sterling because that is the currency of the primary economic environment in which the Company operates.

b) Financial assets and liabilities

The Association has applied the requirements of FRS 102 sections 11 and 12 to the measurement, presentation and disclosure of its financial assets, including investments. Basic financial assets include Investments, Amounts due from investment brokers and Cash and cash equivalents. Basic financial liabilities include Related party balances and Amounts due to investment brokers.

Amount due to and from investment brokers, and Related party balances are recognised at transaction price due to their short term nature. Other accounting policies are shown below.

c) Foreign currencies

Foreign currency transactions 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.

2. Accounting policies (continued)**c) Foreign currencies (continued)**

Foreign currency assets and liabilities including investments are carried at fair value translated into sterling at the rates of exchange ruling at the Balance Sheet date.

The resulting difference is treated as unrealised.

d) Premiums receivable

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 at the balance sheet date.

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.

The 90% quota share reinsurance premium is subject to a discount which is agreed on an annual basis with UKFD&D. The Agreed Discount is recorded on an accruals basis.

e) 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.

f) 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.

Investments are initially measured at cost. Subsequent to initial recognition investments that can be measured reliably are measured at fair value with changes recognised in profit or loss. Fair value is calculated using the bid price at the close of business on the balance sheet date. Listed funds, which consist of Absolute Return Funds, 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.

Gains and losses relating to investments are recognised immediately in the income and expenditure account.

2. Accounting policies (continued)

g) Expenses

Management fees and other general and administrative expenses are recorded on an accruals basis.

h) Derivative financial instruments

Derivatives that do not qualify as hedges (e.g. forward foreign exchange contracts used with the investment portfolio) are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently re-measured at their fair value through the income and expenditure account. The fair value of forward foreign exchange contracts is determined using the forward foreign exchange rates at the measurement date. Derivatives are carried as assets when the fair value is positive and as liabilities when the fair value is negative.

The Association has no derivatives that are designated and qualify as hedges of a highly probably forecast transaction.

i) Debtors

Debtors are carried at cost less impairment which is considered to be a suitable proxy for fair value. Debtors are reviewed for impairment as part of the annual impairment review of debtors.

j) 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, as they are subject to insignificant risk of changes in fair value, are measured at cost.

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

3. Critical accounting estimates and judgements

The Association makes estimates and assumptions that affect the reported amounts of assets and liabilities. Estimates and judgements are continually evaluated and based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Actual results may differ from these estimates.

The ultimate liability arising from claims made under insurance contracts

The estimation of the ultimate liability arising from claims made under insurance contracts is the Association's most critical accounting estimate. There are several sources of uncertainty that need to be considered in the estimate of the liability that the Association will ultimately pay for such claims. Estimates are made for the expected ultimate cost of claims, whether reported or unreported, at the end of the reporting period. The estimate of IBNR is generally subject to a greater degree of uncertainty than that for reported claims. In calculating the estimated liability, the Association uses a variety of estimation techniques based upon statistical analyses of historical experience which assumes past trends can be used to project future developments (see also note 2(e)).

4 Financial Risk Management

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.

The Board and Managers have sought to establish and embed risk management procedures within the Association through an internal quality management system and a risk management framework which considers and logs potential risks and how they are to be managed. The Board monitors the development and operation of risk management policies and controls in place to mitigate risk through a governance structure which includes an internal audit function.

a) 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 currency exchange rates, affecting both the value of the Association's investments and its 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 profile of the Association's financial assets and liabilities, categorised by settlement currency, at their translated carrying amount, is set out below. Certain amounts may depend on a different underlying currency.

| As at 20 February 2016 | Sterling £'000 | US Dollar £'000 | Euro £'000 | Total £'000 |
|----------------------------------|-------------------|--------------------|---------------|----------------|
| Investments | 37,263 | 9,514 | 3,236 | 50,013 |
| Cash and cash equivalents | 126 | 383 | 2 | 511 |
| Derivative financial instruments | (1,267) | (841) | 2,164 | 56 |
| Due from investment brokers | 573 | 1,060 | - | 1,633 |
| Technical provisions | (25,620) | - | - | (25,620) |
| Due to investment brokers | - | (258) | - | (258) |
| Related party balances | (1,310) | - | - | (1,310) |
| Total | 9,765 | 9,858 | 5,402 | 25,025 |

| As at 20 February 2015 | Sterling £'000 | US Dollar £'000 | Euro £'000 | Total £'000 |
|----------------------------------|-------------------|--------------------|---------------|----------------|
| Investments | 34,519 | 13,589 | 3,760 | 51,868 |
| Cash and cash equivalents | 124 | 49 | 7 | 180 |
| Derivative financial instruments | 2,341 | (3,635) | 1,312 | 18 |
| Technical provisions | (25,343) | - | - | (25,343) |
| Related party balances | (1,605) | - | - | (1,605) |
| Total | 10,036 | 10,003 | 5,079 | 25,118 |

4 Financial Risk Management (continued)

A 10 per cent strengthening of the following currencies against Sterling would be estimated to have increased/(decreased) the (loss)/profit before tax and reserves at the year-end by the following amounts:

| As at 20 February 2016 | Effect on (loss)/profit before tax £'000 |
|------------------------|---|
| US dollar | 1,096 |
| Euro | 601 |

| As at 20 February 2015 | Effect on (loss)/profit before tax £'000 |
|------------------------|---|
| US dollar | 1,113 |
| Euro | 567 |

A 10 per cent weakening of these currencies against the Sterling would have an equal and opposite effect.

b) Credit risk

Credit risk is the risk of loss in the value of financial assets due to counterparties failing to meet all or part of their obligations. The Association's exposure primarily relates to amounts recoverable from investment debtors and bank balances.

The following tables provide information regarding aggregate credit risk exposure for significant financial assets with external credit ratings.

The credit rating bands are provided by independent ratings agencies:

| As at 20 February 2016 | AAA £'000 | AA £'000 | A £'000 | Not rated / not readily available £'000 | Total £'000 |
|--|---------------|--------------|--------------|---|----------------|
| Investments | 24,208 | 5,622 | 5,032 | 15,151 | 50,013 |
| Cash and cash equivalents | - | - | 511 | - | 511 |
| Derivative financial instruments | - | - | 70 | - | 70 |
| Due from investment brokers | - | - | - | 1,633 | 1,633 |
| Total assets subject to credit risk | 24,208 | 5,622 | 5,613 | 16,784 | 52,227 |

4 Financial Risk Management (continued)

| As at 20 February 2015 | AAA £'000 | AA £'000 | A £'000 | Not rated / not readily available £'000 | Total £'000 |
|--|---------------|--------------|--------------|--|----------------|
| Investments | 22,718 | 6,629 | 3,449 | 19,072 | 51,868 |
| Cash and cash equivalents | - | - | 180 | - | 180 |
| Derivative financial instruments | - | - | 154 | - | 154 |
| Total assets subject to credit risk | 22,718 | 6,629 | 3,783 | 19,072 | 52,202 |

c) Insurance risk

The Association's risk can arise from:

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

The Association assumes 90% of the retained legal costs and expenses insurance risks of UKFD&D. The Association's exposure to insurance risk is initiated by the UKFD&D's underwriting process and incorporates the possibility that an insured event occurs, leading to a claim on UKFD&D from a member. The risk is managed by the underwriting process, acquisition of reinsurance cover, and the management of claims cost. The Association reviews the results of the reinsurance contract regularly during the year.

The Association establishes provisions for unpaid claims, both reported and unreported, and related expenses to cover its expected ultimate liability. These provisions are established through the application of actuarial techniques and assumptions. In order to minimise the risk of understating these provisions the assumptions made and actuarial techniques employed are reviewed in detail by management.

The Association considers that the liability for insurance claims recognised in the balance sheet is adequate. However, actual experience will differ from the expected outcome.

The Association only provides legal expenses cover to UKFD&D and as a result, no further concentration analysis of risks by cover has been performed.

Some results of sensitivity testing are set out below, showing the impact on income of an increase and decrease in loss ratios. The sensitivity analysis assumes that a change in loss ratio is driven by a change in claims incurred.

| | 2016 £'000 | 2015 £'000 |
|--|---------------|---------------|
| Increase in loss ratio by 5 percentage points – decrease in profit | (408) | (1,692) |
| Decrease in loss ratio by 5 percentage points – increase in profit | 408 | 1,692 |

4 Financial Risk Management (continued)**d) Liquidity risk**

The following table provides a maturity analysis of the Association's financial assets representing the date that a contract will mature, amounts are due for payment or the asset could be realised without significant additional cost.

A portion of Investments are specifically held to settle the Association's technical provisions due to UKFD&D (see note 11A: Debenture).

| As at 20 February 2016 | Within 1 year £'000 | 1 to 5 years £'000 | Over 5 years £'000 | Total £'000 |
|----------------------------------|---------------------------|--------------------------|--------------------------|----------------|
| Investments | 50,013 | - | - | 50,013 |
| Cash and cash equivalent | 511 | - | - | 511 |
| Derivative financial instruments | 56 | - | - | 56 |
| Due from investment brokers | 1,633 | - | - | 1,633 |
| Technical provisions | (16,891) | (8,502) | (227) | (25,620) |
| Due to investment brokers | (258) | - | - | (258) |
| Related party balances | (1,310) | - | - | (1,310) |
| Total | 33,754 | (8,502) | (227) | 25,025 |

| As at 20 February 2015 | Within 1 year £'000 | 1 to 5 years £'000 | Over 5 years £'000 | Total £'000 |
|----------------------------------|---------------------------|--------------------------|--------------------------|----------------|
| Investments | 51,868 | - | - | 51,868 |
| Cash and cash equivalent | 180 | - | - | 180 |
| Derivative financial instruments | 18 | - | - | 18 |
| Technical provisions | (11,015) | (12,298) | (2,030) | (25,343) |
| Related party balances | (1,605) | - | - | (1,605) |
| Total | 39,446 | (12,298) | (2,030) | 25,118 |

e) Limitation of the sensitivity analyses

The sensitivity analyses above show the impact of a change in one input assumption with other assumptions remaining unchanged. In reality, there is normally correlation between the change in certain assumptions and other factors which would potentially have a significant impact on the effect noted above. There have been no changes to methods and assumptions used in the calculation of sensitivity analyses from the previous year.

4 Financial Risk Management (continued)**f) Capital Management**

The Association maintains capital, comprising of guarantee fund and reserves, consistent with the Association's risk appetite and the regulatory requirements.

The Association's regulator is the Isle of Man Financial Services Authority ("IOMFSA") in the Isle of Man. Under the IOMFSA'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 minimum solvency margin required at the year end was £924,900 (2015: £934,800). At the year end the Association's capital resources included reserves of £25,080,000 (2015: £25,197,000) which exceeded the minimum solvency requirement by £24,155,100 (2015: £24,262,200). The Association, therefore, complied with the externally imposed capital requirements to which it is subject.

The Guarantee Fund represents the initial capital that was required by the IOMFSA.

g) Fair value estimations

In accordance with section 34 of FRS 102, as a financial institution, the Association applies the requirements of paragraph 11.27 of FRS 102. This requires, for financial instruments held at fair value in the balance sheet, disclosure of fair value measurements by level of the following fair value hierarchy

Level 1 – Quoted prices (unadjusted) in active markets for identical assets or liabilities

Level 2 – Inputs other than quoted prices included within Level 1 that are observable for the assets or liability, either directly (that is, prices) or indirectly (that is, derived from prices)

Level 3 – Inputs for the assets or liability that are not based on observable market data (that is, unobservable inputs).

The below table presents the Association's assets measured at fair value by level of the fair value hierarchy:

| | Level 1 £'000 | Level 2 £'000 | Level 3 £'000 | Total £'000 |
|----------------------------------|--------------------------|--------------------------|--------------------------|------------------------|
| As at 20 February 2016 | | | | |
| Investments | 27,312 | 22,701 | - | 50,013 |
| Cash and cash equivalents | 511 | - | - | 511 |
| Derivative financial instruments | - | 70 | - | 70 |
| Total | 27,823 | 22,771 | - | 50,594 |

| | Level 1 £'000 | Level 2 £'000 | Level 3 £'000 | Total £'000 |
|----------------------------------|--------------------------|--------------------------|--------------------------|------------------------|
| As at 20 February 2015 | | | | |
| Investments | 31,550 | 20,318 | - | 51,868 |
| Cash and cash equivalents | 180 | - | - | 180 |
| Derivative financial instruments | - | 154 | - | 154 |
| Total | 31,730 | 20,472 | - | 52,202 |

5. Taxation

The income of the Association is subject to Manx Income Tax at the rate of 0% (2015: 0%).

6. Investment income

| | 2016 £'000 | 2015 £'000 |
|--------------------------------------|-----------------------------|-----------------------------|
| Bank interest | 764 | 697 |
| Bank deposit interest | 8 | 12 |
| Currency gains | 1,051 | 143 |
| Custody and investment managers fees | (14) | (9) |
| Investment income | 1,809 | 843 |

7. General and administrative expenses

| | 2016 £'000 | 2015 £'000 |
|------------------------------------|-----------------------------|-----------------------------|
| Audit fees | 18 | 18 |
| Directors' fees | 30 | 18 |
| Directors' and officers' insurance | 9 | 9 |
| Directors' and managers' travel | 11 | 6 |
| Government fees | 5 | 9 |
| Other expenses | 6 | 2 |
| | 79 | 62 |

8. Management fee

The fee paid to the Managers of £272,200 (2015: £265,000) 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 (see also note 13 for related party disclosures).

9. Investments

| | Cost 2016 £'000 | Fair value 2016 £'000 | Cost 2015 £'000 | Fair value 2015 £'000 |
|--------------------------------|--------------------------------|--------------------------------------|--------------------------------|--------------------------------------|
| Government and corporate bonds | 33,567 | 33,864 | 33,560 | 33,347 |
| Equities | 11,017 | 10,759 | 9,592 | 10,938 |
| Absolute return funds | 2,716 | 3,163 | 3,058 | 3,587 |
| UCITS | 2,191 | 2,227 | 2,671 | 2,663 |
| TMI Income Fund | - | - | 1,250 | 1,333 |
| Total investments | 49,491 | 50,013 | 50,131 | 51,868 |

10. Derivative financial instruments**a) Cash flow hedges**

The Association does not use forward currency contracts that meet the hedge accounting criteria.

b) Non hedge derivatives

Forward currency contracts are entered into in order to manage the currency exposure of the investment portfolio. The contracts are for the forward sale of currencies which are matched by holdings of those currencies. The open contracts have been re-valued at year-end rates of exchange. The profit or loss on exchange on these contracts is included within exchange gains and losses. These are economic hedges, but do not meet the hedge accounting criteria.

The table below analyses all derivative positions:

| | 2016 | | | 2015 | | |
|-----------------------------------|--------------------------------------|---|---|--------------------------------------|---|---|
| | Contract amount £'000 | Fair value asset £'000 | Fair value liability £'000 | Contract amount £'000 | Fair value asset £'000 | Fair value liability £'000 |
| Forward currency contracts | | | | | | |
| Non hedge derivatives | 6,940 | 70 | (14) | 10,961 | 154 | (136) |
| Total | 6,940 | 70 | (14) | 10,961 | 154 | (136) |

11. Debenture

The Association has covenanted to discharge under two debentures certain liabilities to UKFD&D, to whom the Association provides reinsurance.

A. Debenture – fixed charge

- The Association's liabilities under the reinsurance agreement to UKFD&D held in a segregated investment account up to an amount of £16 million.

B. Debenture – floating charge

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

This 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 Financial Services Authority.

12. Technical Provisions

The nature of the business makes it very difficult to predict the likely outcome of any particular case and to estimate the cost of future claims. The estimates for known outstanding claims are based on the best estimates of the Directors of the likely cost of individual cases, and the extent of the Association's current commitment to the cost of these cases. These estimates are as accurate as possible given the details of the cases and taking into account all the current information. The estimates are reviewed regularly.

The movement in the gross provision for claims is the difference between the provision for outstanding claims on all policy years at the beginning of the year and the equivalent provision at the end of the year, after deduction of all claims paid during the financial year and addition of new claims notified in the 2015 policy year.

| Movement in technical provisions | 2016 £'000 | 2015 £'000 |
|---|-----------------------|-----------------------|
| Total at the beginning of the year | 25,343 | 24,980 |
| Claims paid | (9,280) | (8,533) |
| Claims incurred during the year | 9,557 | 8,896 |
| Total at the end of the year | 25,620 | 25,343 |

12. Technical Provisions (continued)

As analysis of technical provisions between those claims due within one year and those due after one year is given below.

| | 2016 £'000 | 2015 £'000 |
|-----------------------------------|-----------------------------|-----------------------------|
| Current | 16,891 | 11,015 |
| Non-current | 8,729 | 14,328 |
| Total technical provisions | 25,620 | 25,343 |

Development claim tables

The development of insurance liabilities provides a measure of the Association's ability to estimate the ultimate value of claims. The table shows a policy year by year analysis of the technical provisions as shown in the balance sheet. The Association has elected to disclose only six years of claims experience data in its claims development tables as permitted by FRS 103 Insurance Contracts. These disclosures will be extended for an additional year in each succeeding year until the 10-year information requirement has been satisfied.

Net estimate of ultimate claims cost attributable to policy year

| Reporting year | 2010/11 £'000 | 2011/12 £'000 | 2012/13 £'000 | 2013/14 £'000 | 2014/15 £'000 | 2015/16 £'000 |
|--|--------------------------------|--------------------------------|--------------------------------|--------------------------------|--------------------------------|--------------------------------|
| - At the end of the reporting year | 9,450 | 10,890 | 10,125 | 9,450 | 9,810 | 9,450 |
| - One year later | 10,170 | 12,285 | 8,235 | 9,090 | 11,340 | - |
| - Two years later | 11,025 | 11,520 | 7,515 | 9,045 | - | - |
| - Three years later | 10,665 | 11,475 | 7,380 | - | - | - |
| - Four years later | 11,482 | 10,530 | - | - | - | - |
| - Five years later | 10,620 | - | - | - | - | - |
| Current estimate of cumulative claims | 10,620 | 10,530 | 7,380 | 9,045 | 11,340 | 9,450 |
| Cumulative payments to date | (9,648) | (9,441) | (5,481) | (6,165) | (6,138) | (1,710) |
| Liability in the balance sheet | 972 | 1,089 | 1,899 | 2,880 | 5,202 | 7,740 |
| Total liability relating to the last six policy years | | | | | | 19,782 |
| Prior years reserve | | | | | | 5,838 |
| Total technical provisions in the balance sheet | | | | | | 25,620 |

13. 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 2,500 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 FRS 102 Section 33.

At 20 February 2016 £1,310,000 was due to UKFD&D (2015: £1,605,000).

On 11 December 2015 the £50,000 which was due to The United Kingdom Defence Reinsurance Association Limited ("UKDRA") was paid. UKDRA is a wholly owned subsidiary of UKFD&D.

Mr I R Jarrett is also a Director of the Managers, Thomas Miller (Isle of Man) Limited. The Managers' fee is disclosed in Note 8.

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 related party transactions were conducted on an arm's length basis.

14. Explanation of transition to FRS 102

This is the first year that the Association has presented its financial statements under Financial Reporting Standard 102 and 103 as issued by the Financial Reporting Council. The following disclosures are required in the year of transition. The last financial statements under previous UK GAAP were for the year ended 20 February 2015 and the date of transition to FRS 102 was therefore 21 February 2014. As a consequence of adopting FRS 102, a number of accounting policies have changed to comply with that standard.

With regard to the classification of balance sheet items, under FRS 102, Derivative financial instruments are required to be separately identified. In the previous year's financial statements they were classified under the heading 'Investments' in the balance sheet.

The transition to FRS 102 did not have any impact on the income and expenditure account or reserves as shown below.

| | As at 20 February 2015 £'000 | As at 21 February 2014 £'000 |
|--|---|---|
| Reserves as previously stated | 24,980 | 25,097 |
| Adjustments to reserves on transition to FRS 102 | - | - |
| Reserves under FRS 102 | 24,980 | 25,097 |



ABOVE & BEYOND

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