

Above & Beyond

The United Kingdom Freight Demurrage and Defence Association Limited
Annual Report and Consolidated Financial Statements for the year ended
20 February 2020

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Company Number: 00501877

Directors

Directors

E. F. André	
M. Bottiglieri	
I. Caroussis	
B. C. Goulandris	
G. A. Gratsos	
T.S. Huxley	
C. R. Kendall	
Z. Lanshui	
S. Laskaridi	
M. F. Lykiardopulo	
I. Al Nadhairi	Appointed 10 January 2020
M. Nomikos	
S. Palios	
P. Pappas	Chairman since June 2017
M. G. Pateras	
T. A. Stafylopatis	
Y. T. Triphyllis	
M. R. Wade	
G. D. Weston	
B. Maclehose	Appointed on 11 July 2019
G. Goumas	Appointed on 24 July 2019
D.J. Evans	

Company Secretary

K.P. Halpenny

Auditors

BDO LLP
150 Aldersgate Street
London EC1A 4AB

The United Kingdom Freight Demurrage and Defence Association Limited ("the Association") carries on the business of mutual insurance of its Members against legal costs and expenses relating to the operation of ships entered with the Association as defined in the Rules of the Association.

During the year the Association incorporated the United Kingdom Freight Demurrage and Defence Insurance (Europe) Limited ("UKDE"). UKDE is a Cypriot company that has been established as part of the Association's contingency planning for Brexit. Currently UKDE is in the final stages of obtaining an insurance license from the Cyprus Ministry of Finance and as such is a non-trading company.

Under a revised agreement dated 31 October 2019, the Association reinsures 90 per cent of its risks to The United Kingdom Defence Insurance Association (Isle of Man) Limited ("UKDIA").

The number of ships entered in the Association at the year-end on 20 February 2020 was 3,721 (3,043 owned and 678 chartered), compared with 3,796 (3,027 owned and 769 chartered) on 20 February 2019.

Financial Review

As shown in the Association's Consolidated Income and Expenditure Account on page 20, the year ended with a profit on the technical account of £0.1 million (2019: £0.86 million loss). After investment income, exchange gains/losses and taxation, there was an overall surplus for the year of £0.15 million (2019: £0.03 million surplus). The surplus for the year was mainly caused by reduced reinsurance premium and a favourable investment return for the year.

The combined loss ratio for the year stands at 99% (2019: 110%) excluding the impact of foreign currency on the Association's results.

During the year under review the Association has seen a small increase in premium levels driven mainly by a modest weakening in Sterling relative to US Dollars over the course of the year. Since a large proportion of the Association's business is written in US Dollars, the value of Sterling, relative to US Dollars, has an impact on the Association's results and represents a risk for the Association should Sterling strengthen. To manage this risk the Association hedges its US Dollar premium income through the use of forward currency contracts as further detailed in notes 4 and 13 of the financial statements.

The surplus for the year led to a rise in the Association's accumulated Income and expenditure account reserves (shown on the Balance Sheet of the Association, set out on page 21) from a surplus of £4.64 million at 20 February 2019 to a surplus of £4.79 million at 20 February 2020. In terms of cash flow the Association's short-term deposits and cash and cash equivalents are sufficient to cover its net claims reserves.

The Association's gross claims reserves at 20 February 2020 were £29.26 million (2019: £30.74 million), an overall decrease of £1.48 million in the year which was mostly offset by a decrease in the Association's reinsurance claims reserves.

The reserves at 20 February 2020, together with calls made on Members after that date, are available and, in the opinion of the Directors, meet the Association's outgoing and the legal costs and other expenses of the Association's business.

The Directors consider the metrics discussed above the key performance indicators of the Association given that these indicators drive the financial wellbeing of the Association.

The Association's approach to financial risk management and a review of the principal risks and uncertainties is disclosed in note 4 of the financial statements, which includes the financial risks on climate change. The principal risks are considered to be currency risk, insurance risk and credit risk of reinsurance arrangements, the mitigation of which is further discussed in note 4. In addition to the risks discussed in note 4 the Board of the Association has identified Cyber risk and failure of IT system security as additional key risks that the Association faces. These risks, and their respective controls, are monitored by the Association's Board through review of the Association's business risk log.

Likely future developments that may affect the Association are further discussed in the Report of the Directors on page 8.

Companies Act Section 172(1)

Section 172(1) of the Companies Act 2006 provides that a Director of a Company must act in a way that is considered to be in good faith, would most likely promote the success of the Association and benefit the Members as a whole, and in doing so have regard to various other stakeholder interests, including the Managers, regulators, brokers and reinsurers.

As a mutual insurer, the Association exists for the benefit of its Members, who are also the insureds of the Association. The key factors under section 172(1) are further considered below:

1. The likely consequences of any long term decision.

As further outlined above, the Directors have recently elected to establish a subsidiary in Cyprus. This decision was made so that the Association can continue to write business to European Members once the transition period expires following the UK's exit from the European Union, and as such the decision has been taken with the best interests of the Members in mind.

2. The interests of the Association's employees

The full executive function of the Association is outsourced to Thomas Miller Defence Limited. As such the Association has no employees.

3. The need to foster the Association's business relationships with suppliers, customers and others.

In terms of the wider community impacted by the Association, as a mutual insurer, the Association exists for the benefit of its Members, who are also insureds of the Association. To this end the Association's Board aims to provide a high quality service for a competitive price. The Association targets a 100% combined loss ratio and has, in recent years, distributed excess funds back to Members by way of Continuity Credits.

The Association outsources management of the day-to-day operations to Thomas Miller Defence Limited. In this regard, the Board has established a Management Fee Committee that considers the Association's relationship with Thomas Miller Defence Limited. The Management Fee Committee ensures that any business conducted with Thomas Miller Defence Limited is done so on appropriate terms.

The Association has strong relationships with its brokers and reinsurers and through its Managers the Association maintains contact and high level engagement with the management of its key brokers and reinsurers. The Board receive updates on the Association's key broker and reinsurer relationships.

4. The impact of the Association's operations on the community and the environment.

As a service orientated organisation, the Association's does not consider to have a material impact on the environment. The Board has established a policy on climate changes which is owned by the Association's Risk Officer that considers the risk of climate change associated with the Association. The Association considers the best interests of its Members as priority. This includes returning excess funds to its Members by way of continuity credits, but also supporting cases that will have a benefit to the wider shipping community and acting as a sounding Board for industry issues through various topical conferences and seminars conducted throughout the year.

5. The desirability of the Association maintaining a reputation for high standards of business conduct.

The Board has in place a conduct risk policy that applies to both the Board and the Managers and ensures that the Association does the right things for its customers whilst keeping them, and the integrity of the markets in which they operate at the heart of everything that the Association does.

6. The need to act fairly between Members of the Association.

The conduct risk policy as referred to above, ensures that customers are treated fairly. In addition the Board has established a conflicts of interest policy which ensures that any conflict of interest around Member issues are appropriately disclosed and dealt with at a Board level.

The Directors therefore considers that the requirements of Section 172(1) are appropriately addressed within the Association's policies and procedures.

Approved by the Board of Directors and signed on behalf of the Board.

K. P. Halpenny

Secretary
30 April 2020

Report of the Directors

The Directors have pleasure in presenting their Report and the Financial Statements of the Group for the year ended 20 February 2020.

Directors

The Directors who held office during the year are listed on page 4.

In accordance with the Articles of Association, all the Directors retire at the forthcoming Annual General Meeting to be held on 17 September 2020 and will be eligible for re-election.

Meetings of Directors

The Directors met on five occasions during the year under review, in order to fulfil the general and specific responsibilities entrusted to them by the Members under the Rules and under the Memorandum and Articles of Association. At these meetings the Directors received and discussed written and oral reports and recommendations from the Managers on calls and other policy matters.

A substantial portion of each meeting involved the consideration of Members' cases in which the Association's support was requested for court or arbitration proceedings, the Directors considering 24 major cases during the year. The Managers also considered a substantial number of requests for support in proceedings under the authority delegated to them by the Directors and reports on those cases were presented to the Board at each meeting. Of all the requests for support formally considered by the Board, in excess of 90% received a significant measure of support from the Association, illustrating the importance attached by both Board and Managers to the Association being supportive of its Members whenever the circumstances render that possible.

The work of the Association remains substantial with approximately 2,682 case files open as at 20 February 2020. The Managers continue to advise and support Members who are involved with disputes and are frequently able to help them reach satisfactory terms of settlement without proceedings.

Future Developments

Likely future developments that will affect the Association include the impact of Brexit on the Association's future European business activities. The Board of Directors has established a subsidiary of the Association in Cyprus to enable the Association to continue to insure European Membership. The Association is in the final stage of securing an insurance license from the Cypriot Ministry of Finance. This will enable the Association to continue to write business to European Members post Brexit, which is expected to represent less than a quarter of the Association's total book of business.

In January, 2020 new regulations have come in to force that require ships to utilise low sulphur fuel. This will present technical, commercial and contractual challenges for shipowners and operators. There is the potential for a wide range of disputes to arise for existing contracts which were entered in to prior to the regulations coming in to force. The Association has been working for some time to raise Members' awareness of certain of the issues in order to minimise the potential for disputes.

Impact of COVID-19 on The Association

The emergence and spread of COVID-19, or the so-called Coronavirus, could have an impact on the Association. As a service organisation, the Association is able to continue to service its Members remotely, and therefore the disruption caused by COVID-19 has not materially impacted the Association's ability to operate on an ongoing basis. COVID-19 is considered to be a non-adjusting post balance sheet event. Further details can be found in note 21 of the financial statements.

The impact of COVID-19 on the Association is considered in more detail below:

Impact on Insurance Operations

COVID-19 emerged in December 2019, and was classified as a global pandemic in March 2020. With the Association's year-end being 20 February, 2020, it is expected to have a very limited impact on the 2019/20 policy year and therefore the 20 February 2020 year end, given that COVID-19 was at a relatively early stage at the time that the year ended. The Association's technical provisions, its most critical accounting estimate, is therefore not considered to be impacted by COVID-19.

Looking past the 20 February, 2020 year-end, the Association has seen a small number of cases opened of which the vast majority relate to provision of general advice which, usually, do not carry any material value. All cases opened are currently at a very early stage and therefore difficult to determine what the final outcome may be.

Whilst COVID-19 will most likely impact the Association's claims provisions for the 2020/21 policy year, it is not considered that it will be of the magnitude to materially impair the Association's robust capital position and strong risk mitigation. The Association continues to receive the benefit of a comprehensive reinsurance programme, with only 10% of risk being retained within the Association.

Regarding the reinsurance programme, the Association places an excess of loss programme, predominantly in the Lloyd's market. Under the Association's risk appetite, all excess of loss reinsurances are required to be rated A- or better. The Association's 90% quota share reinsurance arrangement with UKDIA benefits from a fixed charge debenture over the assets of UKDIA. With UKDIA in a strong net assets position the Association's reinsurance programme is expected to continue to effectively mitigate the Association's insurance risk.

In terms of the Association's Membership and its obligation to pay premium debt to the Association, there has been no indication of any material default in Membership obligations. The 2019/20 policy year is substantially collected, whilst satisfactory progress is being made on collection of the first instalment of the 2020/21 policy year premium. The risk of default is mitigated by the fact that claims may be cancelled along with the outstanding premium of any defaulting Member.

Impact on Investment Operations

As per note 4 of the Consolidated Financial Statements, the Association's financial assets are mostly held in short term deposits and cash and cash equivalents. As a result the Association has not been exposed to the global decline in investment markets as a result of COVID-19.

The Association hedges the currency risk of US Dollar premium receipts through the use of forward currency contracts with maturities of up to three years. As further discussed in notes 2 and 13 of the Consolidated Financial Statements, these contracts are accounted for as cash flow hedges. Any fluctuation in Sterling, relative to US Dollar will result in fluctuations in the Association's derivative financial instruments. Given that these instruments qualify as cash flow hedges, any fluctuation on the hedging instrument will be offset by an opposite move on the hedged item. Significant fluctuations in currencies are therefore not considered to materially impact the Association's ability to continue as a going concern.

Regarding cash flow risk, as mentioned above, the Association has not identified any immediate creditworthiness issues in Membership, and therefore does not consider there to be a material cash flow risk, as a result of COVID-19, at present. Furthermore, the Association's cash flow is implicitly supported by the Association's reinsurance contract with UKDIA.

Impact on Solvency II Capital Coverage

Given the Association's robust position as further discussed above, and following stress and scenario testing performed, the Association is expected to continue to meet all Solvency II capital requirements. The Association furthermore benefits from an Ancillary Own Funds allowance which bolsters the Association's own funds position from a regulatory perspective.

Impact on going concern

The Directors have performed an assessment of the expected impact of COVID-19. As mentioned above, and following initial stress and scenario analysis performed, COVID-19 is not expected to materially impair the Association's ability to continue as a going concern.

Directors' and Officers' Liability

The Board of Directors has effected a Directors' and Officers' Liability Insurance policy to indemnify the Directors and Officers of the Association against loss arising from any claim against them jointly or severally by reason of any wrongful act in their capacity as Directors or Officers of the Association. The insurance also covers the Association's loss when it is required or permitted to indemnify the Directors or Officers pursuant to common law, statute, or the Articles of Association. The cost of the insurance is met by the Association and is included in net operating expenses.

Report of the Directors (continued)

Auditor

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

- 1) so far as the Director is aware, there is no relevant audit information of which the Association's auditor is unaware;
- 2) the Director has taken all the steps that he/she ought to have taken as a Director in order to make himself/herself aware of any relevant audit information and to establish that the Association's auditor is aware of the information.

This confirmation is given and should be interpreted in accordance with the provisions of s418 of the Companies Act 2006.

A resolution to reappoint BDO LLP as the Association's auditor will be proposed at the forthcoming Annual General Meeting.

Directors' Report Disclosures

The Association's financial instruments comprise its financial investments, cash, and various items arising directly from operations such as insurance and other debtors, technical provisions and creditors. The main risks arising from these financial instruments are credit risk, market risk, and insurance risk. The Association's approach to management of these risks is disclosed in note 4 of the financial statements.

Directors' Responsibilities Statement

The directors are responsible for preparing the Strategic Report and Report of the Directors 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 elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable laws, including FRS 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland"). 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 and profit or loss of the Association 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 UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements;
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Association will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Association's transactions and disclose with reasonable accuracy at any time the financial position of the Association 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 Association and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Approved by the Board of Directors and signed on behalf of the Board.

K. P. Halpenny
Secretary
30 April 2020

Independent Auditor's Report

Independent Auditors Report to the Members of the United Kingdom Freight Demurrage and Defence Association Limited

Our opinion

We have audited the financial statements of The United Kingdom Freight Demurrage and Defence Association Limited ('The Association') and its subsidiaries (the 'Group') for the year ended 20 February 2020 which comprise the Consolidated Income and Expenditure Account, Consolidated Statement of Comprehensive Income, Consolidated and Company Balance Sheet, Consolidated and Company Statement of Changes in Reserves, Consolidated Cash Flow Statement and notes to the financial statements, including a summary of significant accounting policies. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards, including Financial Reporting Standard 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland and Financial Reporting Standard 103 Insurance Contracts (United Kingdom Generally Accepted Accounting Practice).

In our opinion the financial statements:

- the financial statements give a true and fair view of the state of the Group and of the Association's affairs as at 20 February 2020 and the surplus for the year then ended;
- the Group and Association's financial statements have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of our report. We are independent of the Association in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard as applied to public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independent Auditor's Report (continued)

Conclusions relating to going concern

We have nothing to report in respect of the following matters in relation to which the ISAs (UK) require us to report to you where:

- the Directors' use of the going concern basis of accounting in the preparation of the financial statements is not appropriate; or
- the Directors have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the Group's or the Association's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) we identified, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. We no longer consider Hedge Accounting as a key audit matter. We have reviewed the methodology in the prior year and have gained necessary assurance that the methodology does not include complex judgements or estimates and is appropriate.

Key audit matter	How our audit addressed the key audit matter
<p>Valuation of technical provisions and reinsurer's share of technical provisions</p> <p>There is a risk that inappropriate assumptions and judgements are made when determining the valuation of technical provisions. As such, the valuation of technical provisions both gross and net of reinsurance is a key area of focus within the financial statements and to our audit.</p> <p>As per note 18 and accounting policy 2e (Claims) the Association's financial statements record gross technical provisions of £29.3m (2019: £30.7m), and net technical provisions of £2.8m (2019: £2.9m). This is made up of individual case estimates and claims Incurred But Not Reported ('IBNR').</p> <p>1. Case estimates rely on:</p> <ul style="list-style-type: none"> ▪ The expertise of the claims handlers and their experience of assessing claims in different jurisdictions; ▪ The correct and timely entry of claims information onto the claims system before the year end; ▪ Adjustments being made to significant year end estimates and payments being absorbed by the Association's assessment of claims IBNR. <p>2. IBNR modelling is reliant on:</p> <ul style="list-style-type: none"> ▪ Relevant claims data being input correctly into actuarial models; and ▪ The application of appropriate actuarial techniques, judgements and assumptions. <p>Claims handlers only provide case estimates to the next stage of authorisation, increasing the risk that case reserves may be understated. As such a greater reliance is placed on the Association's internal actuaries to reserve adequately by entering sufficient IBNR to compensate for any risk of under reserving within case estimates.</p> <p>3. The Association has reduced its insurance risk through quota share and excess of loss reinsurance arrangements. Reinsurer's share of technical provisions is reliant on the assumptions and judgements applied when establishing gross technical provisions.</p>	<p>We have performed the following:</p> <p>Valuation of Case Estimates:</p> <ul style="list-style-type: none"> ▪ Agreed all case estimates above our performance materiality level to supporting documentation such as legal correspondence, to assess whether case estimates are valued appropriately. ▪ We have carried out testing on the operating effectiveness of the controls over claim estimates, ensuring that estimates are reviewed every six months and have been appropriately revised on review, where applicable. <p>Cut-off of Case Reserves:</p> <ul style="list-style-type: none"> ▪ Agreed claim adjustments above performance materiality and payments around the year end to supporting documentation and bank statements, to assess whether these adjustments and payments were accounted for in the correct period. <p>Valuation of IBNR:</p> <ul style="list-style-type: none"> ▪ Reconciled the key actuarial inputs used in actuarial models to accounting records. ▪ Assessed the methodology, significant judgements and assumptions applied by the Association's actuarial team through the use of our in-house actuarial team. ▪ Reviewed the outturn of prior years' claims IBNR with reference to the last five years, to assess IBNR held against the subsequent claims development. <p>Valuation of Reinsurance share of Technical Provisions:</p> <ul style="list-style-type: none"> ▪ Recomputed recoveries on the Association's quota share reinsurance arrangements through application of the ceding percentage to the technical provisions subject to quota share based on the agreement; and ▪ Assessed the accuracy of the excess of loss reinsurance calculations through identification of claims eligible for recovery and recalculating the reinsurers share in line with the excess of loss reinsurance programme.

Conclusion of findings

Based on our audit procedures we have gained assurance that technical provisions and reinsurance share of technical provisions are fairly stated.

Independent Auditor's Report (continued)

Our application of materiality

In planning and performing our audit we were guided by our application of materiality. We set certain quantitative measures and thresholds for materiality, which together with other, qualitative, considerations, helped us to determine the scope of our audit and the nature, timing and extent of the procedures performed.

The Association and Group has in place a significant amount of quota share reinsurance. This arrangement has the effect of transferring insurance premium and claims technical provisions to reinsurers. Due to the extent of these arrangements it was felt appropriate to set a financial statements materiality to determine the extent of audit procedures to be applied over gross written premiums and gross claims before these reinsurance arrangements. A specific level of materiality has been set for transactions and balances not affected by quota share reinsurance.

Group financial statement materiality is set at the same level as the Association's financial statement materiality, as the only subsidiary of the Group has not commenced trading in the financial period and the Group's net asset position is the same as the Association. The Association became a parent company of the Group in the financial period, following the establishment of The United Kingdom Freight Demurrage and Defence Insurance (Europe) Limited. As such this is the first year that consolidated financial statements have been prepared for the Association, so there is no comparative Group's financial statements materiality for the year ended 20 February 2019.

Financial statements materiality for the Group and Association in relation to gross written premiums and gross claims was set at £335,000 (2019: £320,000). The principal determinant in this assessment was the Association's gross premiums written, which we consider to be the most relevant benchmark, as it reflects the overall scale of premiums and claims transactions within the accounts. Our materiality was set at 2% of this number.

The specific level of materiality has been based on net assets, as the key performance indicator for stakeholders is the economic stability of the Association. Our specific level materiality was £95,000 (2019: £116,000), being set at 2% of total assets net of total liabilities.

Performance materiality is the application of materiality at the individual account or balance level set at an amount to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality for the financial statements as a whole. Performance materiality was set at £250,000 (2019: £240,000) being 75% (2019: 75%) of financial statement materiality set out above based on the low level of misstatements in the past and our overall assessment of the control environment.

Specific performance materiality has been set at £71,250 (2019: £87,000) being 75% of specific materiality (2019: 75%).

We have agreed with the Audit, Regulatory and Risk Committee that we shall report to them any misstatements in excess of £16,750 (2019: £16,000) that we identify through the course of our audit, together with any qualitative matters that warrant reporting.

Independent Auditor's Report (continued)

An overview of the scope of the audit

Our audit was scoped by obtaining an understanding of the Association, the overall Group and its environment, and assessing the risks of material misstatement. The Group's one subsidiary, United Kingdom Defence Insurance (Europe) Limited (incorporated in Cyprus), did not start trading as an insurance company during the financial year. BDO LLP performed audit procedures on all balances and transactions of this entity that are material to the Group.

Our approach to the audit was risk based, with our audit work being tailored to ensure that sufficient assurance was gained for us to be able to give an opinion on the financial statements as a whole. Specific audit procedures were carried out on all risk areas identified, including the key audit matters detailed above, and on all material balances and classes of transactions. The company audit team performed all aspects of the audit.

Effectiveness of the audit on the identification of possible fraud

The primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management. Our responsibilities are to gain reasonable assurance that the financial statements are not materially misstated as a result of fraud or otherwise. As part of our audit we identified possible risks of material misstatements of the financial statements due to fraud. We considered the primary fraud risks to be around the misappropriation of assets and fraudulent reporting, as well as the valuation of technical provisions and reinsurers' share of technical provisions. Our approach to the valuation of technical provisions and reinsurers' share of technical provisions has been addressed above.

We designed our audit by determining materiality and assessing the risks of material misstatement in the financial statements. In particular, we considered where management made subjective judgements, for example in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain. We also addressed the risk of management override of internal controls and the risk of fraud in revenue recognition, including evaluating whether there was evidence of bias by management that represented a risk of material misstatement due to fraud.

We identified areas of laws and regulations that could reasonably be expected to have a material impact on the financial statements from our sector experience and through discussion with the directors and other management, as required by the auditing standards. As with any audit, there remained a risk of non-detection of irregularities, as these may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal controls.

Independent Auditor's Report (continued)

Other information

The directors are responsible for the other information. The other information comprises the information included in the annual report and financial statements, other than the financial statements and our auditor's report thereon.

Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Opinion on other matters prescribed by the Companies Act 2006

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

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

Matters on which we are required to report by exception

In the light of the knowledge and understanding of the Group and the Association and its environment obtained in the course of the audit, we have not identified material misstatements in the Strategic Report or the Directors' Report.

We have nothing to report in respect of the following matters in relation to which The Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept by the Association, or returns adequate for our audit have not been received from branches not visited by us; or
- the Association financial statements and the part of the Directors' remuneration report to be audited are not in agreement with the accounting records 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.

Independent Auditor's Report (continued)

Responsibilities of Directors

As explained more fully in the Directors' Responsibilities Statement on page 11, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the Association's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Association or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists.

Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

Matters on which we are required to address

Following the recommendation of the Audit, Risk & Regulatory Committee, we were appointed on 20 October 2016 to audit the financial statements for the year ending 20 February 2017 and subsequent financial periods. The period of total uninterrupted engagement is 4 years, covering the years ending 20 February 2017 to 20 February 2020.

The non-audit services prohibited by the FRC's Ethical Standard were not provided to the Group and Association and we remain independent of the Group and Association in conducting our audit.

Our audit opinion is consistent with the additional report to the Audit, Regulatory and Risk Committee.

Independent Auditor's Report (continued)

Use of our report

This report is made solely to the Association's Members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Association'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 Association and the Association's members as a body, for our audit work, for this report, or for the opinions we have formed.

Alexander Barnes
Senior Statutory Auditor

For and on behalf of;
BDO LLP Statutory Auditor
London, UK
11 May 2020

Accounts

Consolidated Income and Expenditure Account Year ended 20 February 2020

	Notes	2020 £'000	2019 £'000
Technical Account			
Gross premiums written		16,835	16,732
Outward reinsurance premiums	5	(6,830)	(8,085)
Net premiums written and earned		10,005	8,647
Claims incurred net of reinsurance	18	(5,270)	(5,126)
Net operating expenses	7	(4,634)	(4,379)
Balance on the technical account		101	(858)
Non-Technical Account			
Balance on the technical account		101	(858)
Investment income	10	80	38
Exchange gains / (losses)		(17)	865
Surplus on ordinary activities before tax		164	45
Tax on activities	17	(12)	(15)
Surplus on ordinary activities after tax and transferred to reserves		152	30

Consolidated Statement of Comprehensive Income Year ended 20 February 2020

	Notes	2020 £'000	2019 £'000
Surplus on ordinary activities after tax		152	30
Other comprehensive income			
Amounts recycled into surplus		693	237
Fair value loss		(746)	(2,233)
		(53)	(1,996)
Total comprehensive income for the year		99	(1,966)

All activities represent continuing activities.
The notes on pages 24 to 40 form an integral part of these Financial Statements.

Accounts

Consolidated and Parent Company Balance Sheet 20 February 2020

	Notes	Consolidated		Parent company	
		2020 £'000	2019 restated £'000	2020 £'000	2019 restated £'000
ASSETS					
Investments					
Shares in subsidiary undertakings	20	-	-	3,160	-
Other financial investments	12	4,541	5,237	4,541	5,237
Derivative financial instruments	13	153	161	153	161
Reinsurers' share of technical provisions	18	26,460	27,803	26,460	27,803
Debtors	14	412	399	412	399
Cash and cash equivalents	15	4,045	3,802	885	3,802
Total assets		35,611	37,402	35,611	37,402
RESERVES					
Income and expenditure account		4,790	4,638	4,793	4,638
Hedging reserve	13	(502)	(449)	(502)	(449)
Total reserves		4,288	4,189	4,291	4,189
LIABILITIES					
Technical provisions	18	29,261	30,742	29,261	30,742
Derivative financial instruments	13	647	610	647	610
Creditors	16	1,415	1,861	1,412	1,861
Total liabilities		31,323	33,213	31,320	33,213
Total liabilities and reserves		35,611	37,402	35,611	37,402

The financial statements of The United Kingdom Freight Demurrage and Defence Association Limited, registration number 00501877, were approved by the Board of Directors and authorised for issue on 30 April 2020. They were signed on its behalf by:

Directors: P. Pappas | C. R. Kendall

Managers: D. J. Evans

The notes on pages 24 to 40 form an integral part of these Financial Statements.

Accounts

Consolidated Statement of Changes in Reserves Year ended 20 February 2020

	Attributable to members		
	£'000 Income and expenditure account	£'000 Hedging reserve	£'000 Total
Balance at 20 February 2018	4,608	1,547	6,155
Surplus for the year	30	-	30
Other comprehensive income for the year	-	(1,996)	(1,996)
Total comprehensive income for the year	30	(1,996)	(1,966)
Balance at 20 February 2019	4,638	(449)	4,189
Surplus for the year	152	-	152
Other comprehensive income for the year	-	(53)	(53)
Total comprehensive income for the year	152	(53)	99
Balance at 20 February 2020	4,790	(502)	4,288

Parent Company Statement of Changes in Reserves Year ended 20 February 2020

	Attributable to members		
	£'000 Income and expenditure account	£'000 Hedging reserve	£'000 Total
Balance at 20 February 2018	4,608	1,547	6,155
Surplus for the year	30	-	30
Other comprehensive income for the year	-	(1,996)	(1,996)
Total comprehensive income for the year	30	(1,996)	(1,966)
Balance at 20 February 2019	4,638	(449)	4,189
Surplus for the year	155	-	155
Other comprehensive income for the year	-	(53)	(53)
Total comprehensive income for the year	155	(53)	102
Balance at 20 February 2020	4,793	(502)	4,291

The notes on pages 24 to 40 form an integral part of these Financial Statements.

Consolidated Cash Flow Statement
Year ended 20 February 2020

Notes	2020 £'000	2019 £'000
Operating activities		
Calls and premiums received	16,730	18,754
Reinsurance premium paid	(7,352)	(7,877)
Claims paid	(12,012)	(13,811)
Reinsurance recoveries received	6,704	8,386
Acquisition costs	(828)	(797)
Operating expenses paid	(3,680)	(3,388)
Interest and dividends received	80	38
Taxation paid	(16)	(3)
Net cash provided by operating activities	(374)	1,302
Investing activities		
Purchase of investments	(11,487)	(12,397)
Sale of investments	12,183	14,240
Net cash provided in investing activities	696	1,843
Net increase in cash and cash equivalents	322	3,145
Cash and cash equivalents at the beginning of the year	3,802	1,624
Effect of exchange rate fluctuations on cash and cash equivalents	(79)	(967)
Cash and cash equivalents at the end of the year	4,045	3,802

The notes on pages 24 to 40 form an integral part of these Financial Statements.

1. Constitution and General Information

The Association is incorporated in England as a private company limited by guarantee and not having a share capital.

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 during the preceding six years.

2. Accounting Policies

a) Accounting disclosures

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 – "Financial Reporting Standard applicable in the United Kingdom and the Republic of Ireland" and FRS 103 – "Insurance contracts" issued by the Financial Reporting Council.

These financial statements which consolidate the financial statements of the Association and its subsidiary undertakings have been prepared under the Companies Act 2006. The Association and its subsidiary undertakings have applied uniform accounting policies and on consolidation all intra-group transactions, profits, and losses have been eliminated.

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 Association operates. This has been selected on the basis that materially all of the Association's claims and expenses are paid in pounds sterling, and the Association's main reinsurance contract with UKDIA is denominated in pounds sterling.

The Association has taken exemption from presenting a parent profit and loss account under section 408 of Companies Act 2006. The Association has taken exemption from presenting a parent Statement of Cash Flows under section 1.12(b) of FRS 102.

The Financial Statements have been prepared on the going concern basis. The Directors consider it appropriate to adopt the going concern basis of accounting in the preparation of these Financial Statements and are not aware of any material uncertainties to the Association's ability to continue to do so for at least 12 months from the date of authorisation of these Financial Statements.

b) Foreign currencies

Foreign currency monetary assets and liabilities are translated into sterling at the rates of exchange ruling at the balance sheet date. The resulting difference is treated as unrealised. The costs of investments are translated into sterling at the rate applicable for the date on which they were purchased.

Revenue transactions are translated into sterling at the rate applicable for the date on which they took place.

All exchange gains/losses other than on forward exchange contracts that are designated and qualify as hedges (see 2(g)), whether realised or unrealised have been included in the Consolidated Income and Expenditure Account for the year.

c) Gross premiums written

Calls and premiums are presented net of return premiums and continuity credits and 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. Continuity credits represent a reduced premium amount for longstanding Members and are recognised as part of the related premium amount. There are no unearned premiums as all policies expire on or before the balance sheet date.

d) Outward reinsurance premiums

Outward reinsurance premiums are the total payable in respect of excess of loss and quota share reinsurances for the period to which the relevant contracts relate. Quota share reinsurance premiums are subject to an agreed discount, the rate of which for each policy year is agreed with UKDIA.

The agreed discount is recognised in the Consolidated Income and Expenditure Account when corresponding reinsurance premiums are recognised.

(e) Claims

These are the legal costs and expenses of the Members covered by the Association. They include all claims incurred during the year, whether paid, estimated or unreported, together with internal claims, management costs and future claims management costs and adjustments for claims outstanding from previous years.

A forecast of unreported claims is based on the estimated ultimate cost of claims arising out of events which have occurred before the end of the accounting period but have not yet been reported. The Directors' estimate for these future claims is based on the estimate of unreported claims on each policy year. The estimates are calculated by comparing the pattern of claims payments and estimates in current policy years with earlier policy years, and then projecting the outcomes of the more recent years.

The Association utilises a variety of actuarial techniques to determine its ultimate liability which include development factor methods, Bornhuetter-Ferguson methods and a bootstrapping methodology. These techniques assume that the future will be broadly similar to the past.

The Association assesses at the end of each reporting period whether its recognised insurance liabilities are adequate using current estimates of future cash flows under its insurance contracts. If that assessment shows that the carrying amount of its insurance liabilities is inadequate, the entire deficiency is recognised in the Consolidated Income and Expenditure Account.

Whilst the Directors consider that the gross provisions for claims and the related reinsurance recoveries 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 dealt with in the technical accounts of later years.

The Association enters into reinsurance contracts in the normal course of business in order to limit potential losses arising from certain exposures. Reinsurance assets include balances due from reinsurance companies for paid and unpaid losses. Reinsurance assets are measured consistently with the amounts associated with the underlying insurance contracts and in accordance with the terms of the reinsurance contract.

The Association's gross and reinsurance Technical Provisions include a provision for claims Incurred But Not Reported "(IBNR)". In previous years, the Association's IBNR provision for excess of loss reinsurances was shown net against gross IBNR. Further details on the impact of this change in approach may be found in note 22.

(f) Other financial investments

The Association has applied the requirements of FRS 102 sections 11 and 12 to the measurement, presentation and disclosure of its financial assets. Investments in short term deposit funds and the foreign exchange security deposit are designated in the Balance Sheet at fair value through profit and loss. Fair value is calculated using the bid price at the close of business on the balance sheet date.

Those purchased in foreign currencies are translated into sterling on the date of purchase. The fair value of foreign currency investments is translated at the rate of exchange ruling at the balance sheet date.

(g) Derivative financial instruments

Derivatives 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. Derivatives are carried as assets when the fair value is positive and as liabilities when the fair value is negative.

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges of a highly probably forecast transaction is recognised in other comprehensive income. The gain or loss relating to any ineffective portion is recognised immediately in the Consolidated Income and Expenditure Account. Changes in the fair value of derivatives that do not qualify for hedge accounting are recognised directly in the Consolidated Income and Expenditure Account.

Amounts accumulated in reserves are recycled to surplus in the periods in which the hedged item affects profit or loss.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in Other Comprehensive Income and is recognised when the forecast transaction is ultimately recognised in the Consolidated Income and Expenditure Account.

When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in Other Comprehensive Income is immediately transferred to the Consolidated Income and Expenditure Account.

(h) Cash and cash equivalents

Cash and cash equivalents includes cash in hand, deposits held at call with banks, other short-term highly liquid investments with original maturities of three months or less and bank overdrafts. Bank overdrafts, when applicable, are shown within borrowings in current liabilities.

(i) Debtors

Debtors are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Receivables arising from insurance contracts are also classified in this category and include Members' contributions, claims deductibles recoverable from Members and reinsurance receivables. Debtors are carried at cost less impairment. Debtors are reviewed for impairment as part of an ongoing and annual review.

(j) Investment income

This comprises income received during the year adjusted in respect of interest receivable at the year end, and profits and losses on the sale of investments and gains and losses on closed forward currency contracts.

The unrealised gains and losses on the movement in the fair value of the investments are included in the non-technical account. No transfer is made of the investment returns from the non-technical account to the technical account, as this is not considered appropriate given the Association mono-line nature.

(k) Taxation

The payment of taxation is deferred or accelerated because of timing differences between the treatment of certain items for accounting and taxation purposes. Full provision for deferred taxation is made under the liability method, without discounting, on all timing differences that have arisen, but not reversed by the balance sheet date, unless such provision is not permitted by FRS 102 section 29. Currently no timing differences exist that results in any deferred tax assets or liabilities.

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. The outcome on claims can significantly deviate from both initial estimates and the estimates as disclosed in the financial statements. 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. For further detail refer to note 2(e) and note 18.

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, liquidity risk and operational risk.

The Board and Managers have sought to establish and embed risk management procedures within the Association through a Compliance manual, 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 and various committees.

The Association manages the risks relating to the operations of the Association through internal risk reports which analyse exposures by degree and magnitude of 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 currency 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.

Due to the Association's revenue being materially received in US Dollars, the Association has implemented a hedging strategy whereby the Association uses forward contracts to mitigate the potential currency risk on its future premium income. Forward currency contracts have been designated as hedging instruments and the Association regards its future premium income as a highly probable forecast transaction and has designated it as a hedged item under hedge accounting requirements. This relationship has been designated by the Association as cash flow hedges and is monitored by the Association's Board of Directors. In addition, the Association utilises an investment mandate that matches the currency of its assets and liabilities.

The profile of the Association's assets and liabilities, categorised by settlement currency, at their translated carrying amount, is set out on the following page. Certain amounts may depend on a different underlying currency.

4. Financial Risk Management (continued) Market risk (continued)

As at 20 February 2020	Sterling £'000	US Dollar £'000	Euro £'000	Total £'000
Short term deposit funds	745	1	-	746
Foreign exchange security deposit	3,795	-	-	3,795
Derivative financial instruments	31,630	(32,125)	-	(494)
Reinsurers' share of technical provisions	18,802	4,376	3,282	26,460
Debtors	99	304	10	412
Cash and cash equivalents	3,367	622	57	4,045
Technical provisions	(20,801)	(4,834)	(3,626)	(29,261)
Creditors	(1,258)	(90)	(66)	(1,415)
	36,378	(31,746)	(344)	4,288

As at 20 February 2019	Sterling £'000	US Dollar £'000	Euro £'000	Total £'000
Short term deposit funds	1,632	13	-	1,645
Foreign exchange security deposit	2,816	776	-	3,592
Derivative financial instruments	20,068	(20,517)	-	(449)
Reinsurers' share of technical provisions	19,505	4,741	3,556	27,803
Debtors	114	269	16	399
Cash and cash equivalents	3,312	473	17	3,802
Technical provisions	(21,575)	(5,238)	(3,929)	(30,742)
Creditors	(1,779)	(72)	(10)	(1,861)
	24,094	(19,555)	(350)	4,189

A 5 per cent strengthening / weakening of the following currencies against sterling would be estimated to have increased / (decreased) the surplus before tax, reserves and Other Comprehensive Income ("OCI") at the year-end by the following amounts:

As at 20 February 2020	Strengthening		Weakening	
	Effect on OCI £'000	Effect on surplus after tax £'000	Effect on OCI £'000	Effect on surplus after tax £'000
Dollar	(1,683)	104	1,537	(125)
Euro	-	(17)	-	17

As at 20 February 2019	Strengthening		Weakening	
	Effect on OCI £'000	Effect on surplus after tax £'000	Effect on OCI £'000	Effect on surplus after tax £'000
Dollar	(1,080)	48	977	(48)
Euro	-	(17)	-	17

4. Financial Risk Management (continued)**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 objective is to reduce credit risk through the risk management techniques discussed below.

The Association's exposure primarily relates to amounts recoverable from reinsurance contracts, debtors and bank balances. Exposure to reinsurance counterparties is mitigated by the Association placing its excess of loss reinsurances with counterparties rated A- or better. On its 90% reinsurance programme, given that UKDIA is unrated, the Association has the benefit of a legal charge in the form of a fixed charge debenture over UKDIA's assets which mitigate the Association's exposure to Reinsurers' share of technical provisions. Exposure to debtors, which is mainly in respect of calls and premium contributions, is spread over a large number of Members and counterparties, which mitigates the risk. Exposure to bank balances, however, is more concentrated, with two main counterparties and the risk is mitigated by placing funds surplus to normal operational requirements in money market funds and other investments.

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

The credit rating bands are provided by independent ratings agencies:

As at 20 February 2020	AAA £'000	AA - A £'000	BBB £'000	Not rated / not readily available £'000	Total £'000
Short term deposit funds	746	-	-	-	746
Foreign exchange security deposit	-	1,260	2,535	-	3,795
Derivative financial instruments	-	(345)	(149)	-	(494)
Reinsurers' share of technical provisions	-	-	-	26,460	26,460
Debtors	-	-	-	412	412
Cash and cash equivalents	-	4,045	-	-	4,045
Total assets subject to credit risk	746	4,960	2,386	26,872	34,964

As at 20 February 2019	AAA £'000	AA - A £'000	BBB £'000	Not rated / not readily available £'000	Total £'000
Short term deposit funds	1,645	-	-	-	1,645
Foreign exchange security deposit	-	1,076	2,516	-	3,592
Derivative financial instruments	-	(83)	(366)	-	(449)
Reinsurers' share of technical provisions	-	-	-	27,803	27,803
Debtors	-	-	-	399	399
Cash and cash equivalents	-	3,802	-	-	3,802
Total assets subject to credit risk	1,645	4,795	2,150	28,202	36,792

4. Financial Risk Management (continued)

Insurance risk

The Association's risk can arise from:

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

The objective of the Association's insurance risk management process is to support the execution of effective underwriting, reinsurance and reserving strategies which are agreed and monitored by the Association's Board.

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 statement of financial position is adequate. However, actual experience will differ from the expected outcome.

The Association only provides legal expenses cover to its Members 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 surplus after tax, of an increase and decrease in loss ratios gross and net of reinsurance. The sensitivity analysis assumes that a change in loss ratio is driven by a change in claims incurred.

	2020 £'000	2019 £'000
Increase in loss ratio by 5 percentage points		
Gross	(842)	(837)
Net	(84)	(84)

A 5 per cent decrease in the loss ratio would have an equal and opposite effect.

Liquidity risk

The Association manages this risk by the use of liquid investments and its ability to call upon its quota share reinsurer, UKDIA, in the event of a significant outflow of funds. The Association also has the benefit of a legal charge in the form of a debenture over UKDIA's investments and other assets.

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

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

As at 20 February 2020	Within 1 year £'000	1 to 5 years £'000	Over 5 years £'000	Total £'000
Assets and liabilities				
Short term deposit funds	746	-	-	746
Foreign exchange security deposit	3,795	-	-	3,795
Derivative financial instruments	(508)	13	-	(494)
Reinsurers' share of technical provisions	7,802	14,856	3,802	26,460
Debtors	412	-	-	412
Cash and cash equivalents	4,045	-	-	4,045
Technical provisions	(8,628)	(16,429)	(4,205)	(29,261)
Creditors	(1,415)	-	-	(1,415)
Total	6,250	(1,560)	(403)	4,288

As at 20 February 2019	Within 1 year £'000	1 to 5 years £'000	Over 5 years £'000	Total £'000
Assets and liabilities				
Short term deposit funds	1,645	-	-	1,645
Foreign exchange security deposit	3,592	-	-	3,592
Derivative financial instruments	(255)	(194)	-	(449)
Reinsurers' share of technical provisions	8,688	15,162	3,953	27,803
Debtors	399	-	-	399
Cash and cash equivalents	3,802	-	-	3,802
Technical provisions	(9,504)	(16,846)	(4,392)	(30,742)
Creditors	(1,861)	-	-	(1,861)
Total	6,506	(1,878)	(439)	4,189

Operational risk

Operational risks relate to the failure of internal processes, systems or controls due to human or other error. In order to mitigate such risks the Association has engaged Thomas Miller Defence Limited as managers to document all key processes and controls in a procedural manual. This manual is embedded into the organisation and available to all staff. Compliance with the procedures and controls documented within the manual is audited on a regular basis through quality control checks and the internal audit function which is directed and reviewed by the Audit and Risk Committee. A human resource manual including all key policies have also been documented.

4. Financial Risk Management (continued)**Financial Risks from Climate Change**

In April 2019 the PRA published Supervisory Statement 3/19, "Enhancing banks' and insurers' approaches to managing the financial risks from climate change", which sets out their expectations as to how firms will manage the financial risks relating to climate change. To this end, the Association has put in place a policy and plan for the exposure, identification and management of risk relating to climate change. As a service organisation, the Association considers that there is no direct risk for the Association to climate change, however as part of the Association's Own Risk and Solvency Assessment ("ORSA") process under Solvency II the risks around climate change have been included in the Association's scenario analysis. Any impact on the Association may manifest itself in the Association's claims exposure. The Association continues to monitor its claims for any underlying trends.

Capital Management

The Association maintains capital, comprising of surplus and reserves, consistent with the Association's risk appetite and the regulatory requirements. Under the Solvency 2 regime introduced on 1 January 2016, the Association has been approved by its regulator a capital benefit associated with the Association's ability to make a contingency call to its Members.

The Association continues to be regulated in the United Kingdom by the Prudential Regulation Authority ("PRA") and Financial Conduct Authority ("FCA"). Under the Solvency 2 regime the Association is obliged to assess and maintain the amount of capital required to meet the risks that it faces based on a 99.5 per cent confidence level of solvency. Throughout the period the Association complied with all regulatory capital requirements.

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.

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:

As at 20 February 2020	Level 1 £'000	Level 2 £'000	Level 3 £'000	Total £'000
Short term deposit funds	746	-	-	746
Foreign exchange security deposit	3,795	-	-	3,795
Derivative financial instruments	-	(494)	-	(494)
Cash and cash equivalents	4,045	-	-	4,045
Total	8,566	(494)	-	8,092
As at 20 February 2019	Level 1 £'000	Level 2 £'000	Level 3 £'000	Total £'000
Short term deposit funds	1,645	-	-	1,645
Foreign exchange security deposit	3,592	-	-	3,592
Derivative financial instruments	-	(449)	-	(449)
Cash and cash equivalents	3,802	-	-	3,802
Total	9,039	(449)	-	8,590

4. Financial Risk Management (continued)**Financial instruments**

The table below provides an analysis of the Association's financial assets and liabilities by class of recognition:

	2020 £'000	2019 £'000
Financial assets measured at fair value through profit or loss	8,586	9,039
Financial assets measured at amortised cost	412	399
Net financial assets measured at fair value through other comprehensive income	(494)	(449)
Financial liabilities measured at amortised cost	(1,415)	(1,861)

5. Gross Premiums Written and Outward Reinsurance Premiums

	2020 £'000	2019 £'000
Gross Premiums written	16,835	16,732
Excess loss premium	(649)	(591)
90% quota share premium	(13,822)	(13,810)
Agreed discount on 90% quota share premium	7,641	6,316
	(6,830)	(8,085)

Gross Premiums Written are written directly with Members and are classified as legal costs insurance.

The 90% quota share reinsurance premium is calculated after the impact of any excess of loss reinsurance and is subject to a discount which is agreed on an annual basis with the reinsurance quota share provider, UKDIA.

6. Gross Claims Paid

	2020 £'000	2019 £'000
Legal costs and expenses	(7,449)	(9,318)
Claims handling costs and management fee	(4,656)	(4,269)
	(12,105)	(13,587)

7. Net Operating Expenses

	Notes	2020 £'000	2019 £'000
General Management		(2,883)	(2,643)
Directors' remuneration	9	(238)	(215)
Auditor's remuneration:			
Audit fees in relation to the audit of the Association's annual accounts		(61)	(47)
Brokerage		(828)	(797)
Other expenses		(856)	(890)
		(4,866)	(4,592)
Net operating expenses allocated to claims handling		232	213
		(4,634)	(4,379)

8. Management Fee

The fee covers the Managers', Thomas Miller Defence Limited's, costs of providing offices, staff and administration. It is fixed by the Directors in accordance with the Rules. No loan has been made to the Managers and none is contemplated. The Association itself had no employees throughout the year.

The management fee is apportioned between the different management functions and consists of acquisition costs, which include the cost of underwriting and credit control; claims handling costs; and other costs which include accounting, regulatory compliance, and general management. The fee is allocated to these functions on the basis of the underlying cost elements to the management fee which are included in amounts in notes 6 and 7.

9. Directors' Fees

	2020 £'000	2019 £'000
Aggregate emoluments	(238)	(215)

Pension contributions are not made in respect of any of the Directors. The Directors' fees for the highest paid director amounted to £30,000 during the current year.

10. Investment Income

	2020 £'000	2019 £'000
Bank deposits	47	16
Return on short term deposit funds	33	22
	80	38

11. Rates of Exchange

The year end rates of exchange equivalent to £1 were:	2020	2019
US dollar	1.2879	1.3064
Euro	1.1922	1.1511

12. Investments

	Fair Value		Cost	
	2020 £'000	2019 £'000	2020 £'000	2019 £'000
Short term deposit funds	746	1,645	746	1,645
Foreign exchange security deposit	3,795	3,592	3,795	3,592
Total	4,541	5,237	4,541	5,237

	2020 £'000	2019 £'000
Percentage of cash and interest bearing securities repayable: within one year	100%	100%

The foreign exchange security deposit is charged to The Royal Bank of Scotland plc and the Bank of New York Mellon, London branch, as collateral in respect of the Association's forward currency contracts.

13. Derivative financial instruments

	2020			2019		
	Contract notional amount £'000	Fair value asset £'000	Fair value liability £'000	Contract notional amount £'000	Fair value asset £'000	Fair value liability £'000
Non-hedge contracts	1,921	8	-	-	-	-
Cash flow hedges	29,710	145	(647)	20,067	161	(610)
Total	31,631	153	(647)	20,067	161	(610)

The Association uses forward currency contracts to hedge the foreign exchange risks that it is exposed to as a result of future income being received in United States Dollars. Future premium income is regarded as a highly probable forecast transaction and is designated as a hedged item. Forward currency contracts in relation to the hedged item are designated as a hedging instrument. The relationship between the hedged item and hedging instruments is designated as a cash flow hedge under hedge accounting requirements.

Gains and losses in reserves on forward foreign exchange contracts as at 20th February 2020 will be released to the Income and Expenditure Account over the next two years to match the receipt of future income. All amounts reported as other comprehensive income in the Consolidated Statement of Comprehensive income relate to cash flow hedges.

The hedging reserve on the Balance Sheet is represented by a net loss of £502,000 (2019: loss of £449,000) on cash flow hedges as per the table above.

There was no ineffective portion attributable to these hedges.

14. Debtors

	2020 £'000	2019 £'000
Arising out of insurance operations		
Members' contributions	160	9
Claims deductibles recoverable	115	170
	275	179
Other debtors	137	220
Total debtors	412	399

Debtors arising out of direct insurance operations include a provision for impairment of £192,000 (2019: £180,000) resulting in an increase of £12,000 in the current year (2019: increase of £20,000).

Debtors arising out of direct insurance operations include an amount of £266,000 (2019: £163,000) that are past due, but not impaired.

15. Cash and cash equivalents

	Consolidated		Parent company	
	2020 £'000	2019 £'000	2020 £'000	2019 £'000
Cash at bank and in hand	4,045	3,802	885	3,802
Total cash and cash equivalents	4,045	3,802	885	3,802

16. Creditors

	Consolidated		Parent company	
	2020 £'000	2019 £'000	2020 £'000	2019 £'000
Arising out of insurance operations				
Members' contributions	10	24	10	24
Claims creditors	189	138	189	138
Due to quota share reinsurer	986	1,509	986	1,509
	1,185	1,671	1,185	1,671
Other creditors				
Corporation tax payable	12	16	12	16
PAYE and social security	6	5	6	5
Other creditors	22	2	22	2
Accruals and deferred income	190	168	187	168
	230	191	227	191
Total Creditors	1,415	1,861	1,412	1,861

17. Taxation

Taxation is in respect of United Kingdom corporation tax on its assessable investment income and gains/losses at current rates of taxation.

Analysis of tax charge for the year:	2020 £'000	2019 £'000
Corporation tax at 19% (2019: 19%)	12	16
Prior year adjustment	-	(1)
Total current tax	12	15
Reconciliation of tax amount		
Surplus on ordinary activities before tax	164	45
Surplus on ordinary activities before tax multiplied by standard rate of corporation tax in the UK of 19%	31	9
Non-taxable balance on technical account	(19)	163
Non-taxable exchange losses	-	(156)
Prior year adjustment	-	(1)
	12	15

18. Technical Provisions

	2020 £'000	2019 restated £'000
Technical provisions		
Gross technical provisions	29,261	30,742
Reinsurers' share of gross technical provisions	26,460	27,803
Total net technical provisions	2,801	2,939
Current	826	815
Non-Current	1,975	2,124

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 2020 policy year.

The movement on net incurred claims for prior policy years was an improvement of £283,000 (2019: improvement of £278,000).

Development claim tables

The development of insurance liabilities provides a measure of the Association's ability to estimate the ultimate value of claims. The top half of the table below illustrates how the Association's estimate of total claims outstanding for each policy year has changed at successive year-ends. The bottom half of the table reconciles the cumulative claims to the amount appearing in the statement of financial position.

18. Technical Provisions (continued)

Gross estimate of ultimate claims cost attributable to policy year (£'000)

Reporting year	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20
- At the end of the reporting year	10,500	12,100	11,250	10,500	10,900	10,500	12,150	11,023	11,513	9,600
- One year later	11,300	13,650	9,150	10,100	13,072	10,115	9,323	9,184	10,735	
- Two years later	12,250	12,800	8,350	10,050	16,707	8,757	8,394	7,948		
- Three years later	11,850	12,750	8,200	9,643	16,591	9,179	7,717			
- Four years later	12,758	11,700	8,135	9,089	16,590	8,860				
- Five years later	11,800	11,950	8,050	8,870	15,923					
- Six years later	11,960	12,250	7,893	8,853						
- Seven years later	11,780	12,067	7,531							
- Eight years later	12,110	11,945								
- Nine years later	12,113									
Current estimate of cumulative claims	12,113	11,945	7,531	8,853	15,923	8,860	7,717	7,948	10,735	9,600
Current payments to date	11,827	11,531	7,096	8,115	13,960	7,503	6,040	4,756	5,384	1,447
Gross liability recognised on balance sheet	286	414	435	738	1,963	1,357	1,677	3,193	5,351	8,153
Total gross liability relating to the last ten policy years										23,567
Other claims liabilities										5,695
Total gross technical provisions included on balance sheet										29,261

Net estimate of ultimate claims cost attributable to policy year (£'000)

Reporting year	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20
- At the end of the reporting year	1,050	1,210	1,125	1,050	1,090	1,050	1,215	1,091	1,131	960
- One year later	1,130	1,365	915	1,010	1,260	1,012	916	893	1,030	
- Two years later	1,225	1,280	835	1,005	1,560	870	825	780		
- Three years later	1,185	1,275	820	962	1,518	905	758			
- Four years later	1,276	1,170	813	900	1,508	873				
- Five years later	1,180	1,195	805	883	1,455					
- Six years later	1,196	1,225	785	885						
- Seven years later	1,176	1,198	750							
- Eight years later	1,205	1,185								
- Nine years later	1,205									
Current estimate of cumulative claims	1,205	1,185	750	885	1,455	873	758	780	1,030	960
Cumulative payments to date	1,183	1,153	710	812	1,270	750	604	476	538	145
Net liability recognised in the balance sheet	22	32	40	73	185	122	153	304	492	815
Total net liability relating to the last eight policy years										2,240
Other claims liability										562
Total net technical provisions included on the balance sheet										2,802

18. Technical Provisions (continued)

	2020			2019 restated		
	Gross £'000	RI £'000	Net £'000	Gross £'000	RI £'000	Net £'000
Movement in technical provisions						
Total at the beginning of the year	30,742	27,803	2,939	30,498	27,516	2,982
Claims paid	(12,105)	(6,704)	(5,401)	(13,587)	(8,386)	(5,201)
Claims incurred during the year	10,685	5,415	5,270	13,520	8,394	5,126
Exchange differences and other movements	(61)	(54)	(7)	311	279	32
Total at the end of the year	29,261	26,460	2,801	30,742	27,803	2,939

19. Related Party Disclosures

The Association has no share capital and is controlled by the Members who are also the insureds. The subsequent insurance transactions are consequently deemed to be between related parties, but these are the only transactions between the Association and the Members.

All, but one, of the Directors are current representatives of Member companies and other than the insurance, which is arranged on an arm's length basis, and Member interests of these companies, the Directors have no financial interests in the Association. Directors' fees are disclosed in note 9.

The Association reinsures with UKDIA on a 90% quota share basis. All Members of the Association are automatically also Members of UKDIA. However, none of the Directors of the Association are Directors of UKDIA. Additionally, UKDIA operates under a separate governance and operational structure, has its own rulebook, and is therefore not considered to be a related party of the Association.

20. Investment in Subsidiary

Name of subsidiary	Country of incorporation	Class of shares held	Principal activity	Proportion of shares and voting rights
The United Kingdom Freight Demurrage and Defence Insurance (Europe) Limited	Republic of Cyprus	Ordinary	Non-trading	100%

The above subsidiary's registered office is at Theklas Lysioti, 37, GEMINI HOUSE, Office 202, 3030, Limassol, Cyprus. The closing value of the investments is £3,160,000 at the statement of financial position date. The only transaction in the above subsidiary for the year was an audit accrual of £2,500.

The Directors consider the value of these investments to be supported by their underlying assets. No impairment is considered to be required.

21. Events after the reporting period

As further discussed in the Directors' Report, the emergence of COVID-19 may have a potential impact on the Association. The Association continues to be in a strong position given that the 2020/21 policy year is now substantially renewed, limited claims cost have been noted on COVID-19 to date and the Association's investment portfolio is not materially exposed to the volatility that COVID-19 has introduced.

The impact of COVID-19 is however not expected to materially affect the results reported in these financial statements given that the Association's insurance policies cover risks up to 20 February, 2020. As a result the emergence of COVID-19 is considered to be a non-adjusting event after the end of the reporting period, given that the event is indicative of conditions that arose after the end of the reporting period.

The Association has considered a number of scenarios around the impact of COVID-19 on the future results of the Association. This includes a scenario for a 30% fall in equity values and a 1.5% fall in cash and fixed income values, a scenario of an increase in claims of 20%, and a prolonged weakening in Sterling relative to US Dollars. In these scenarios, the expected loss does not exceed 8% of the current income and expenditure account.

As noted in the Directors' report, it continues to be appropriate to prepare the Association's financial statements on a going concern basis.

22. Restatement of prior year amounts

In previous financial years, the Association's Technical Provisions included claims incurred by not reported ("IBNR") net of excess of loss reinsurances. This year the Association decided to change its approach in the area and recognise claims IBNR gross of excess of loss reinsurances. This was done to improve the transparency around disclosure of its Technical Provisions.

This resulted in an increase to the 2019 year-end technical provisions and reinsurance technical provisions, as presented in the Consolidated and Parent Company Balance Sheet, to the amount of £1,351,000 respectively. In addition the 2019 year end gross and reinsurance claims incurred, as presented in note 18, increased by £674,000 respectively.

Given that this adjustment represents a gross-up of reinsurance IBNR, the net impact on the Association's reserves is zero.

Managers

Thomas Miller Defence Limited

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J.W.M. Binner
S.J. Griffiths
K. G. Moore
S. L. Murphy
W. D. van der Westhuysen

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