

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

Directors' Report and Financial Statements

For the year ended 20 February 2022



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Directors, Officers and Managers

The United Kingdom Defence Insurance Association (Isle Of Man) Limited

Directors

K.L. Marshall
Y. Botonakis
G. Panayides
P. Seaward
D.R. Dennett
N. Verardi (appointed 21 October 2021)

Manager

Thomas Miller (Isle of Man) Limited
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Secretary

Thomas Miller (Isle of Man) Limited
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Investment Manager

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Report of the Directors

The Directors have pleasure in presenting their Report and the Financial Statements of the Association for the year ended 20 February 2022.

Principal Activity

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 4.

Review of the Year

Operations for the year resulted in a profit of £893,000 (2021 loss: £77,000).

Directors' Responsibilities Statement

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 Association and of the 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 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 Association will continue in business.

The Directors are responsible for keeping proper 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 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 Association and to prevent and detect fraud and other irregularities.

Auditors

Moore Stephens LP, 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
19 May 2022

Independent Auditors' Report

Independent Auditors' Report to the Members of The United Kingdom Defence Insurance Association (Isle of Man) Limited

Opinion

We have audited the financial statements of The United Kingdom Defence Insurance Association (Isle of Man) Limited (the 'company') for the year ended 20 February 2022 which comprise the Income and Expenditure Account, Balance Sheet, Statement of Changes in Reserves, 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 FRS 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland" and FRS 103 "Insurance Contracts" (United Kingdom Generally Accepted Accounting Practice).

In our opinion, the financial statements:

- give a true and fair view of the state of the company's affairs as at 20 February 2022 and of its profit for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Isle of Man Companies Acts 1931 to 2004, as modified by the Insurance Act 2008.

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 Auditors' responsibilities for the audit of the financial statements section of our report. We are independent of the company 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, and we have fulfilled our 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 audit opinion.

Conclusions relating to going concern

In auditing the financial statements, we have concluded that the director's use of the going concern basis of accounting in the preparation of the financial statements is appropriate.

Based on the work we have performed, we have not identified any material uncertainties relating to events or conditions that, individually or collectively, may cast significant doubt on the company's ability to continue as a going concern for a period of at least twelve months from when the financial statements are authorised for issue.

Our responsibilities and the responsibilities of the directors with respect to going concern are described in the relevant sections of this report.

Other information

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

Independent Auditors' Report (continued)

Independent Auditors' Report to the Members of The United Kingdom Defence Insurance Association (Isle of Man) Limited

Other information (continued)

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.

Matters on which we are required to report by exception

In the light of the knowledge and understanding of the company and its environment obtained in the course of the audit, we have not identified material misstatements in the directors' report.

We have nothing to report in respect of the following matters where the Isle of Man Companies Acts 1931 to 2004 requires us to report to you if, in our opinion:

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

Responsibilities of directors

As explained more fully in the Directors' Responsibilities Statement set out on page 5, 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 company'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 company or to cease operations, or have no realistic alternative but to do so.

Auditors' 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 auditors' 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.

Irregularities, including fraud, are instances of non-compliance with laws and regulations. We design procedures in line with our responsibilities, outlined above, to detect material misstatements in respect of irregularities, including fraud. The extent to which our procedures are capable of detecting irregularities, including fraud is detailed below.

Independent Auditors' Report (continued)

Independent Auditors' Report to the Members of The United Kingdom Defence Insurance Association (Isle of Man) Limited

Explanation as to what extent the audit was considered capable of detecting irregularities, including fraud

The objectives of our audit in respect of fraud, are; to identify and assess the risks of material misstatement of the financial statements due to fraud; to obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement due to fraud, through designing and implementing appropriate responses to those assessed risks; and to respond appropriately to instances of fraud or suspected fraud identified during the audit. However, the primary responsibility for the prevention and detection of fraud rests with both management and those charged with governance of the company.

Our approach was as follows:

- We obtained an understanding of the legal and regulatory requirements applicable to the company and considered that the most significant are the Companies Acts 1931 to 2004, as modified by the Insurance Act 2008.
- We obtained an understanding of how the company complies with these requirements by discussions with management and those charged with governance.
- We assessed the risk of material misstatement of the financial statements, including the risk of material misstatement due to fraud and how it might occur, by holding discussions with management and those charged with governance.
- We inquired of management and those charged with governance as to any known instances of non-compliance or suspected non-compliance with laws and regulations.
- Based on this understanding, we designed specific appropriate audit procedures to identify instances of non-compliance with laws and regulations. This included making enquiries of management and those charged with governance and obtaining additional corroborative evidence as required.

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

Use of our report

This report is made solely to the company's shareholder, as a body, in accordance with Section 15 of the Isle of Man Companies Act 1982. Our audit work has been undertaken so that we might state to the company's shareholder those matters we are required to state to them in an auditors' 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 shareholder as a body, for our audit work, for this report, or for the opinions we have formed.

Moore Stephens LP

Douglas
Isle of Man
19 May 2022

Accounts

Income and Expenditure Account Year ended 20 February 2022

| | Notes | | 2022 £'000 | | 2021 £'000 |
|---|-------|---------|----------------|---------|----------------|
| Premiums | | | | | |
| Premiums receivable | | 14,043 | | 15,905 | |
| Agreed discount | | (7,635) | | (9,376) | |
| | | | 6,408 | | 6,529 |
| Claims | | | | | |
| Claims paid less recoveries | | (7,052) | | (7,906) | |
| Change in provision for outstanding claims | | 50 | | 1,143 | |
| | | | (7,002) | | (6,763) |
| Investment Return | | | | | |
| Investment income | 6 | 558 | | 453 | |
| Gains/(losses) on investments | | | | | |
| Realised | | 1,010 | | 427 | |
| Unrealised | | 321 | | (325) | |
| | | | 1,889 | | 555 |
| Expenses | | | | | |
| Management fee | 8 | (321) | | (322) | |
| General and administrative expenses | 7 | (81) | | (76) | |
| | | | (402) | | (398) |
| Profit /(Loss) for the year | | | 893 | | (77) |

The above results relate to continuing activities of the Company.
The notes on pages 13 to 22 form an integral part of these Financial Statements.

Accounts

Balance Sheet As at 20 February 2022

| | Notes | 2022 £'000 | 2021 £'000 |
|----------------------------------|-------|-----------------|-----------------|
| Assets | | | |
| Investments | 9 | 35,157 | 35,637 |
| Segregated investment account | 9/11B | 16,535 | 16,443 |
| Derivative financial investments | 10 | 32 | 225 |
| Cash and cash equivalents | | 570 | 3,322 |
| Related party balances | 14 | 4,417 | 1,198 |
| Due from investment brokers | | 187 | - |
| Accrued interest | | 27 | 127 |
| Prepaid expenses | | 8 | 7 |
| Total assets | | 56,933 | 56,959 |
| Liabilities | | | |
| Technical provisions | 12 | (24,022) | (24,072) |
| Unearned premiums | 2(d) | (153) | - |
| Derivative financial instruments | 10 | - | (89) |
| Due to investment brokers | | - | (500) |
| Accrued expenses | | (26) | (25) |
| Total Liabilities | | (24,201) | (24,686) |
| Net Assets | | 32,732 | 32,273 |
| Reserves | | | |
| Guarantee fund | | 100 | 100 |
| Income and Expenditure Account | | 32,632 | 32,173 |
| Total Reserves | | 32,732 | 32,273 |

These financial statements were approved by the directors on 19 May 2022.

Directors: P. A. Seaward & D.R. Dennett

Managers: Thomas Miller (Isle of Man) Limited

The notes on pages 13 to 22 form an integral part of these Financial Statements.

Accounts

Statement of Changes in Reserves Year ended 20 February 2022

| | Guarantee Fund £'000 | Income and Expenditure Account £'000 | Total £'000 |
|------------------------------------|-------------------------|--|----------------|
| Balance at 20 February 2020 | 100 | 32,721 | 32,821 |
| Distribution | - | (471) | (471) |
| Loss for the year | - | (77) | (77) |
| Balance at 20 February 2021 | 100 | 32,173 | 32,273 |
| Balance at 20 February 2021 | 100 | 32,173 | 32,273 |
| Distribution | - | (434) | (434) |
| Profit for the year | - | 893 | 893 |
| Balance at 20 February 2022 | 100 | 32,632 | 32,732 |

The notes on pages 13 to 22 form an integral part of these Financial Statements.

Accounts

Cash Flow Statement Year ended 20 February 2022

| | 2022 £'000 | 2021 £'000 |
|---|----------------|----------------|
| Profit/(loss) for the year | 893 | (77) |
| Realised gains on investments | (1,010) | (427) |
| Unrealised exchange gain | - | - |
| Unrealised investment (gain)/loss | (321) | 325 |
| Decrease in claims provision | (50) | (1,143) |
| Increase in unearned premium | 153 | - |
| Decrease in accrued interest | 100 | 40 |
| Decrease in accrued expenses and prepaid expenses | - | (2) |
| Increase in related party balances | (3,219) | (212) |
| Net cash outflow from operating activities | (3,454) | (1,496) |
| Investment activities | | |
| Investment purchases | (71,835) | (68,207) |
| Investment sales | 72,964 | 69,611 |
| Net inflow from investing activities | 1,129 | 1,404 |
| Unrealised exchange gain | 7 | - |
| Distribution | (434) | (471) |
| Net decrease in cash and cash equivalents | (2,752) | (563) |
| Cash and cash equivalents at 21 February | 3,322 | 3,885 |
| Cash and cash equivalents at 20 February | 570 | 3,322 |

The notes on pages 13 to 22 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 a company limited by guarantee and not having a share capital. The Association's Members undertake to contribute such amounts as may be required, not exceeding one pound sterling. 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.

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.

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 revised reinsurance agreement dated 31 December 2015. UKFD&D is a UK based insurance company, related through common membership.

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' and have been recognised within the Income and Expenditure Account. Therefore, the Association has elected to take advantage of the exemption under Paragraph 19 (3) of the Insurance Regulations 2018, not to prepare Regulatory Information.

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 and Cash and cash equivalents. Basic financial liabilities include Related party balances.

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.

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. Unearned premiums at the balance sheet date are deferred and earned in the period which the premiums relate.

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. 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.

2. Accounting Policies (continued)

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 UKFD&D 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.

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.

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 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 probable 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 2022 | Sterling £'000 | US Dollar £'000 | Euro £'000 | Total £'000 |
|----------------------------------|---------------------------|----------------------------|-----------------------|------------------------|
| Investments | 33,845 | 9,323 | 8,524 | 51,692 |
| Cash and cash equivalents | 145 | 378 | 47 | 570 |
| Derivative financial instruments | 10,202 | (5,001) | (5,169) | 32 |
| Technical provisions | (24,022) | - | - | (24,022) |
| Related party balances | 4,417 | - | - | 4,417 |
| Total | 24,587 | 4,700 | 3,402 | 32,689 |

| As at 20 February 2021 | Sterling £'000 | US Dollar £'000 | Euro £'000 | Total £'000 |
|----------------------------------|---------------------------|----------------------------|-----------------------|------------------------|
| Investments | 38,751 | 9,601 | 3,728 | 52,080 |
| Cash and cash equivalents | 3,175 | 146 | 1 | 3,322 |
| Derivative financial instruments | 4,065 | (4,400) | 471 | 136 |
| Technical provisions | (24,072) | - | - | (24,072) |
| Related party balances | 1,198 | - | - | 1,198 |
| Total | 23,117 | 5,347 | 4,200 | 32,664 |

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

Accounts

Notes to the Financial Statements Year ended 20 February 2022

4. Financial Risk Management (continued)

a) Market risk (continued)

As at 20 February 2022

| | Effect on profit/(loss) before tax £'000 |
|-----------|---|
| US Dollar | 427 |
| Euro | 309 |

As at 20 February 2021

| | Effect on profit/(loss) before tax £'000 |
|-----------|---|
| US Dollar | 486 |
| Euro | 381 |

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, where applicable, for significant financial assets with external credit ratings.

The credit rating bands are provided by independent ratings agencies:

As at 20 February 2022

| | AAA £'000 | AA £'000 | A £'000 | B / Not rated / not readily available £'000 | Total £'000 |
|--|--------------|---------------|--------------|--|----------------|
| Investments | 5,596 | 27,875 | 1,479 | 16,742 | 51,692 |
| Cash and cash equivalents | - | - | 120 | 450 | 570 |
| Derivative financial instruments | - | - | - | 32 | 32 |
| Related party balances | - | - | - | 4,417 | 4,417 |
| Total assets subject to credit risk | 5,596 | 27,875 | 1,599 | 21,641 | 56,711 |

As at 20 February 2021

| | AAA £'000 | AA £'000 | A £'000 | Not rated / not readily available £'000 | Total £'000 |
|--|---------------|--------------|--------------|--|----------------|
| Investments | 10,564 | 1,318 | 991 | 39,207 | 52,080 |
| Cash and cash equivalents | - | - | 105 | 3,217 | 3,322 |
| Derivative financial instruments | - | - | - | 136 | 136 |
| Related party balances | - | - | - | 1,198 | 1,198 |
| Total assets subject to credit risk | 10,564 | 1,318 | 1,096 | 43,758 | 56,736 |

4. Financial Risk Management (continued)**c) Reinsurance 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 external 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 reinsurance 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 external 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 reinsurance 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.

| | 2022 £'000 | 2021 £'000 |
|--|-----------------------------|-----------------------------|
| Increase in loss ratio by 5 percentage points – decrease in profit | (703) | (795) |
| Decrease in loss ratio by 5 percentage points – increase in profit | 703 | 795 |

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 2022 | Within 1 year £'000 | 1 to 5 years £'000 | Over 5 years £'000 | Total £'000 |
|----------------------------------|--------------------------------------|-------------------------------------|-------------------------------------|------------------------------|
| Investments | 51,692 | - | - | 51,692 |
| Cash and cash equivalent | 570 | - | - | 570 |
| Derivative financial instruments | 32 | - | - | 32 |
| Technical provisions | (7,814) | (13,073) | (3,135) | (24,022) |
| Related party balances | 4,417 | - | - | 4,417 |
| Total | 48,897 | (13,073) | (3,135) | 32,689 |

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

| As at 20 February 2021 | Within 1 year £'000 | 1 to 5 years £'000 | Over 5 years £'000 | Total £'000 |
|----------------------------------|------------------------|-----------------------|-----------------------|----------------|
| Investments | 52,080 | - | - | 52,080 |
| Cash and cash equivalent | 3,322 | - | - | 3,322 |
| Derivative financial instruments | 136 | - | - | 136 |
| Technical provisions | (7,830) | (13,099) | (3,143) | (24,072) |
| Related party balances | 1,198 | - | - | 1,198 |
| Total | 48,906 | (13,099) | (3,143) | 32,664 |

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.

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 2018 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 £859,800 (2021: £945,250). At the year end the Association's adjusted net assets were £32,732,000 (2021: £32,273,000) which exceeded the minimum solvency requirement by £31,872,200 (2021: £31,327,800). The Association, therefore, complied with the externally imposed capital requirements to which it is subject.

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:

| As at 20 February 2022 | Level 1 £ '000 | Level 2 £ '000 | Level 3 £ '000 | Total £ '000 |
|----------------------------------|-------------------|-------------------|-------------------|-----------------|
| Investments | 39,792 | 11,161 | 739 | 51,692 |
| Cash and cash equivalents | 570 | - | - | 570 |
| Derivative financial instruments | - | 32 | - | 32 |
| Total | 40,362 | 11,193 | 739 | 52,294 |

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Notes to the Financial Statements Year ended 20 February 2022

4. Financial Risk Management (continued)

g) Fair value estimations (continued)

| As at 20 February 2021 | Level 1 £ '000 | Level 2 £ '000 | Level 3 £ '000 | Total £ '000 |
|----------------------------------|-------------------|-------------------|-------------------|-----------------|
| Investments | 18,669 | 33,190 | 191 | 52,080 |
| Cash and cash equivalents | 3,322 | - | - | 3,322 |
| Derivative financial instruments | - | 136 | - | 136 |
| Total | 22,021 | 33,326 | 191 | 55,538 |

5. Taxation

The income of the Association is subject to Manx Income Tax at the rate of 0% (2021: 0%).

6. Investment income

| | 2022 £'000 | 2021 £'000 |
|--------------------------|---------------|---------------|
| Bond interest | 536 | 723 |
| Bank deposit interest | 4 | 8 |
| Currency gains/(losses) | 36 | (259) |
| Custodian fees | (18) | (19) |
| Investment income | 558 | 453 |

7. General and administrative expenses

| | 2022 £'000 | 2021 £'000 |
|------------------------------------|---------------|---------------|
| Audit fees | 19 | 18 |
| Directors' fees | 36 | 40 |
| Directors' and officers' insurance | 11 | 9 |
| Government fees | 9 | 8 |
| Legal and professional fees | 5 | - |
| Other expenses | 1 | 1 |
| | 81 | 76 |

8. Management Fee

The fee paid to the Managers of £321,125 (2021: £321,708) 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 14 for related party disclosures).

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Notes to the Financial Statements Year ended 20 February 2022

9. Investments

| | Cost 2022 £'000 | Fair Value 2022 £'000 | Cost 2021 £'000 | Fair Value 2021 £'000 |
|--------------------------------|-----------------------|-----------------------------|-----------------------|-----------------------------|
| Government and corporate bonds | 36,162 | 35,971 | 34,092 | 34,157 |
| Equities | 12,244 | 14,131 | 12,206 | 13,817 |
| UCITS | 1,589 | 1,590 | 4,106 | 4,106 |
| Total investments | 49,995 | 51,692 | 50,404 | 52,080 |

| | Cost 2022 £'000 | Fair Value 2022 £'000 | Cost 2021 £'000 | Fair Value 2021 £'000 |
|-------------------------------|-----------------------|-----------------------------|-----------------------|-----------------------------|
| Investments | 33,346 | 35,157 | 33,906 | 35,637 |
| Segregated investment account | 16,649 | 16,535 | 16,498 | 16,443 |
| Total investments | 49,995 | 51,692 | 50,404 | 52,080 |

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:

| Forward currency contracts | 2022 | | | 2021 | | |
|----------------------------|-----------------------------|------------------------------|----------------------------------|-----------------------------|------------------------------|----------------------------------|
| | Contract amount £'000 | Fair value asset £'000 | Fair value liability £'000 | Contract amount £'000 | Fair value asset £'000 | Fair value liability £'000 |
| Non hedge derivatives | 11,107 | 32 | - | 23,564 | 225 | (89) |
| Total | 11,107 | 32 | - | 23,564 | 225 | (89) |

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Notes to the Financial Statements Year ended 20 February 2022

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 amounts £16,553,063. This is comprised of £16,534,761 in a segregated investment account, £10,781 included within cash and cash equivalents and £7,521 within accrued interest.

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 policy year.

| Movement in technical provisions | 2022 £'000 | 2021 £'000 |
|-------------------------------------|---------------|---------------|
| Total at the beginning of the year | 24,072 | 25,215 |
| Claims paid | (7,052) | (7,906) |
| Claims incurred during the year | 7,002 | 6,763 |
| Total at the end of the year | 24,022 | 24,072 |

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

| | 2022 £'000 | 2021 £'000 |
|-----------------------------------|---------------|---------------|
| Current | 7,814 | 7,830 |
| Non-current | 16,208 | 16,242 |
| Total technical provisions | 24,022 | 24,072 |

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 statement of financial position.

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Notes to the Financial Statements Year ended 20 February 2022

12. Technical Provisions (continued)

| Reporting year | 2012/13 £'000 | 2013/14 £'000 | 2014/15 £'000 | 2015/16 £'000 | 2016/17 £'000 | 2017/18 £'000 | 2018/19 £'000 | 2019/20 £'000 | 2020/21 £'000 | 2021/22 £'000 |
|--|------------------|------------------|------------------|------------------|------------------|------------------|------------------|------------------|------------------|------------------|
| - At the end of the reporting year | 10,125 | 9,450 | 9,810 | 9,450 | 10,935 | 9,815 | 10,179 | 8,640 | 9,945 | 9,225 |
| - One year later | 8,235 | 9,090 | 11,340 | 9,104 | 8,244 | 8,033 | 9,270 | 8,100 | 8,370 | |
| - Two years later | 7,515 | 9,045 | 14,040 | 7,830 | 7,425 | 7,020 | 8,325 | 7,614 | | |
| - Three years later | 7,380 | 8,658 | 13,658 | 8,145 | 6,818 | 6,435 | 8,235 | | | |
| - Four years later | 7,313 | 8,100 | 13,658 | 7,853 | 6,615 | 6,435 | | | | |
| - Five years later | 7,245 | 7,943 | 13,095 | 7,560 | 6,508 | | | | | |
| - Six years later | 7,065 | 7,965 | 12,735 | 7,534 | | | | | | |
| - Seven years later | 6,750 | 7,916 | 12,725 | | | | | | | |
| - Eight years later | 6,701 | 7,899 | | | | | | | | |
| - Nine years later | 6,703 | | | | | | | | | |
| Current estimate of cumulative claims | 6,703 | 7,899 | 12,725 | 7,534 | 6,508 | 6,435 | 8,235 | 7,614 | 8,370 | 9,225 |
| Cumulative payments to date | 6,435 | 7,478 | 11,678 | 6,982 | 5,775 | 5,565 | 7,017 | 5,286 | 4,333 | 1,625 |
| Liability in the balance sheet | 268 | 421 | 1,047 | 552 | 733 | 870 | 1,218 | 2,328 | 4,037 | 7,600 |
| Net liability for the last 10 policy years | | | | | | | | | | 19,074 |
| Net liabilities for prior years policies | | | | | | | | | | 461 |
| Other Claims reserves | | | | | | | | | | 4,487 |
| Net technical provisions in the balance sheet | | | | | | | | | | 24,022 |

13. 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 2,638 Members and therefore, no one Member is able to assert significant control.

14. Related party disclosures

The Association's principal activity is the business of an insurance company providing reinsurance cover to UKFD&D, 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 2022 £4,416,717 was due from UKFD&D (2021: £1,198,005).

The outstanding balance due from UKFD&D is unsecured, interest free and repayable on demand.

Mr D.R. Dennett is also 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. The investment managers fees are included in the management fees, as shown in note 8.

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

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