Liberty Mutual Insurance Europe Societas Europaea

Annual Report and Financial Statements for the year ended 31 December 2018

Registered Number: B232280 (Registre de Commerce et des Sociétés)

Contents

	Page
Directors and Administration	3
Strategic Report	4
Directors' Report	9
Statement of Directors' Responsibilities	11
Independent auditor's report to the members of Liberty Mutual Insurance SE	12
Income Statement: Technical Account - General Business	19
Income Statement: Non-Technical Account - General Business	20
Statement of Comprehensive Income	21
Statement of Changes in Equity	22
Statement of Financial Position - Assets	23
Statement of Financial Position - Liabilities	24
Notes to the Financial Statements	25

Directors and Administration

Directors

Keith Nicholson	Chairman and Independent Non-Executive Director
Matthew Moore	Director
Nigel Davenport	Director
Philip Hobbs	Director
Graham Brady	Director
Christopher Hanks	Independent Non-Executive Director
Richard Reid	Independent Non-Executive Director
Fernand Grulms	Independent Non-Executive Director

Registered Office
5-7 rue Léon Laval
L-3372 Leudelange
Grand Duchy of Luxembourg

Company Number
B232280 (Registre de Commerce et des Sociétés)

Investment Managers
Liberty Mutual Group Asset Management Inc.

Registered Auditor
Ernst & Young LLP
25 Churchill Place
London E14 5EY

Strategic Report

Principal activity and review of the business

Liberty Mutual Insurance Europe SE (LMIE also referred to as the Company) underwrites Insurance and Reinsurance business from its head office in Grand Duchy of Luxembourg (referred to as Luxembourg) and its branches across Europe. The Company's head office was previously based in the UK.

It is wholly owned by Liberty Mutual Group Incorporated, a diversified global insurer. The group offers a wide range of insurance products and services to meet the needs of individuals, families and businesses through strategic business units and operating units. The Company is part of the Liberty Specialty Markets (LSM) operating unit, which is part of the Global Risk Solutions business unit (GRS).

LMIE announced in July 2017 that it would re-domicile from the UK to Luxembourg. LMIE converted from a UK limited company to a UK public company and subsequently merged with a LSM Luxembourg public company in 2018 to form Liberty Mutual International Europe Societas Europaea (LMIE). The above merger is not deemed to be a business combination. This is to support both its ambitious European growth plans and significant London market operations post Brexit, while maintaining a substantial London presence. Subsequently on 1 March 2019, the Company re-domiciled to Luxembourg.

The Company's key financial performance indicators during the year were as follows:

Key Performance Indicators	**2018**	**2017**
	$000	**$000**
Gross Premiums Written	1,601,356	1,250,662
Net Earned Premium	826,868	642,502
Underwriting Loss	(47,920)	(138,128)
Loss before taxation	(6,982)	(125,572)
Claims Ratio %	**64.9%**	**83.1%**
Expense Ratio %	**40.9%**	**38.4%**
Combined ratio % [i]	**105.8%**	**121.5%**

[i] The combined ratio is the sum of the ratios of net operating expenses and net incurred claims to net earned premiums. A combined ratio of less than 100% represents an underwriting profit.

Underwriting performance

Gross written premiums increased by $351m in 2018, up 28% when compared to 2017. The increase in GWP from prior year is due to growth in the underlying business, particularly in the Reinsurance business.

The claims ratio decreased to 64.9% in 2018 from 83.1% in 2017. This is due to the abnormally high catastrophe losses in the U.S. in the third quarter of 2017. The 2018 result is driven by losses arising from a number of catastrophe events and market losses in the second half of 2018.

Review of financial position

The net assets increased by $303m in the year, mainly due to capital injections of $360m being offset by the recognition of unrealised gains and losses within the portfolio at December 2018 and an overall loss for the year.

Financial investments have increased from $2,369m to $2,595m due to capital injections during the year and offset by the recognition of unrealised gains and losses within the portfolio at December 2018 and the strengthening of the US Dollar against Sterling.

Strategic Report (continued)

Reinsurers' share of technical provisions has increased from $1,198m to $1,259m largely due to an increase in gross technical provisions and offset by changes in the reinsurance programme.

Gross technical provisions increased from $3,417m to $3,803m as GWP continues to grow and offset by catastrophe losses experienced in 2017 continuing to settle.

Investment Performance

Overall, total investment income increased from $30m in 2017 to $53m in 2018 driven by an increase in the investment portfolio as a result of capital injections.

Foreign exchange losses

The foreign exchange loss of $9m (2017: loss of $18m) is driven by the strengthening of USD against GBP (2018: $1.27/£1; 2017: $1.33/£1).

Solvency position

The Company maintains regulatory capital coverage in line with its capital management objective as set out in Note 22. The Solvency II position of the Company is summarised as follows:

	2018 $000	2017 $000
Excess of assets over liabilities	1,250,505	956,236
Solvency Capital Requirement	932,044	749,200
Excess own funds	318,461	207,036

At 31 December 2018, the Company's eligible Own Funds, determined in accordance with the Solvency II valuation rules, were $1,251m (2017: $956m), which was in excess of our estimated SCR of $932m (2017: $749m). This represented a solvency coverage ratio of 134% (2017: 128%), which is within our capital risk appetite. The increase in the solvency coverage ratio is mainly due to capital injections in the year of $360m.

Principal Risks and Uncertainties

The principal risks and uncertainties facing the Company are grouped by management as intrinsic, operational or other risks. Intrinsic risk incorporates the principal risks faced by the Company and includes insurance risk, market risk, credit risk and liquidity risk. Other risk includes group risk and strategic risk.

The objective of the Company's risk management activities is to enable it to engage with risks in a controlled fashion that is consistent with the Board's appetite and its available capital capacity, while retaining the ability to implement its long-term business plans and meet its obligations to policyholders.

Strategic Report (continued)

Intrinsic Risk

Insurance Risk

Insurance risk incorporates premium risk and reserve risk. Premium risk is the variation of underwriting results from plan for reasons other than operational or insurance counterparty risk. This is influenced by the frequency and severity of claims events.

Premium risk is mitigated through the use of a diversified business plan operating within Board risk appetites and supported through the Company's control environment, including underwriting controls. Reinsurance is utilised to mitigate against exposure to individual events.

Reserve risk is the variation in policyholder reserves for prior accident years required for reasons other than operational or insurance counterparty risk. This is influenced by uncertainty in the notification of claims and value of claims paid.

Reserve risk is mitigated through the use of detailed analysis performed by the Actuarial team and overseen by the Reserving Committee, including regular assessment of the results of actuarial studies, claims analysis, underwriting reviews and benchmarking exercises. In addition, business plans are developed to ensure that the long-term reserve profile of the Company remains stable.

Market Risk

Market risk is the risk of fluctuations in net asset value due to the volatility or level of financial variables impacting primarily the value of fixed income securities and private equity funds and other assets and liabilities.

The principal causes of market risks are:

- Interest rate risk: The risk of fluctuations in net asset value due to movements in the term structure of the risk-free rate.
- Spread risk: The risk from of loss arising from widening of asset spreads (differential between bid and ask price of a security).
- Credit risk: comprises
    - Default risk: The risk that a bond defaults and we recover less that the full valuation of the bond.
    - Migration risk: The risk that the credit rating of a bond moves to a lower rating before maturity. Bonds that migrate will experience changes in valuations due to the use of yield curves based on different ratings.
- Private equity risk: The risk of fluctuations in net asset value due to the volatility in the valuation of the private equity funds.
- Currency risk: The risk of fluctuations in net asset value due to changes in the level and volatility of currency exchange rates and mismatches between the assets and liabilities.
- Asset concentration risk: The risk of an exposure having the potential to result in significant large losses.

The following policies and procedures are in place to govern the exposure to market risk.

Strategic Report (continued)

Principal Risks and Uncertainties (continued)

Intrinsic Risk (continued)

- A Market and Liquidity Risk Policy exists that sets out the assessment and determination of what constitutes market risk for the Company.
- The Market and Liquidity Risk Policy details how the Company measures, monitors and mitigates the potential market risks posed by the investment portfolio. Compliance with the policy is monitored with exposures and any breaches reported to the Investment Committee and the Risk Committee. The policy is reviewed regularly for pertinence and for changes in the risk environment.
- The measurement, monitoring and reporting of market risk takes into account the profile of the net technical provisions and is reflective of the financial risk caused by the interaction of the assets and liabilities.

Market risk is mitigated through the use of a diversified investment strategy operating within Board risk appetites and operationalised through the investment guidelines.

Credit Risk

Credit risk is the risk of financial change in value due to actual credit losses deviating from expected credit losses due to the failure of another party to meet its contractual debt obligations. The principal source of credit risk arises from the inability of reinsurers and intermediaries to meet their contractual obligations if they become due.

Credit risk is mitigated through controls encompassing due diligence and continued monitoring to ensure the appropriate selection of counterparties and Board risk appetites to prevent inappropriate credit risk concentrations.

Liquidity Risk

Liquidity risk is the probability of loss arising from situations where the Company either has insufficient cash to meet its financial obligations or is required to sell assets below their fair value to meet cash demands.

Liquidity risk is mitigated through the use of asset-liability modelling and through the maintenance of a diversified and appropriately liquid portfolio of assets.

Operational Risk

Operational risk is the risk of loss to the Company resulting from the inadequate or failed internal processes, people and systems, or from external events. Operational risk also includes reputational risk and conduct risk.

Operational risk is mitigated through the use of the three lines of defence model in conjunction with a system of documented, monitored and tested internal controls.

Strategic Report (continued)

Principal Risks and Uncertainties (continued)

Other Risks

Group risk

Group risk is the risk of loss to the Company arising from its membership of both Liberty Mutual Group and Liberty Specialty Markets.

Group risk is mitigated through the monitoring of Liberty Mutual Group's financial strength and business strategy developments. In addition, the chairman of any Committee reviewing risk information ensures that due attention is given to each legal entity within Liberty Specialty Markets, particularly in times of stress to one entity.

Strategic risk

Strategic risk is the risk of loss to the Company arising from key business decisions, improper implementation of decisions or lack of responsiveness to industry changes.

Strategic risk is mitigated through the development and implementation of the Company's strategy and through controls relating to the development of new business opportunities.

Brexit is a source of potential risk for LMIE given the uncertainty over the UK's future trading relationship with the EU. However, LMIE has taken steps to ensure that it can continue to write European business with minimal disruption to policyholders, brokers and staff.

These risks are covered in more detail in note 22 to the Financial Statements.

Significant events during the reporting period and up to the date of the report

Through its branch structure, the Company has significant operations in the EU and the UK and enjoys a number of benefits from the UK being a member of the EU.

On 23 June 2016, through a referendum, the UK voted to leave the EU and on 29 March 2017, Article 50 of the Lisbon Treaty was triggered by the UK Government commencing the process of formal negotiation between the UK and the EU on the UK's exit. This process is still ongoing and is expected to continue over 2019. A high degree of uncertainty exists around what the terms of the UK's relationship with the EU will be and whether any benefits of the current four freedoms of the EU will remain.

As a result, on 1 March 2019, LMIE redomiciled to Luxembourg, while maintaining its UK presence as a branch.

Directors' Report

The Directors have pleasure in submitting their report, together with the audited Financial Statements of the Company, for the year ended 31 December 2018.

Directors

The current Directors are listed on page 3, Directors who held office between 1 January 2018 and the date of signing the Financial Statements were:

Keith Nicholson	Chairman and Independent Non-Executive Director	
Matthew Moore	Director	
John Dunn	Director	Resigned 5 December 2018
Nigel Davenport	Director	Appointed 10 December 2018
Philip Hobbs	Director	
Frank Robinson	Director	Resigned 22 February 2018
Gordon McBurney	Director	Resigned 26 February 2018
Graham Brady	Director	Appointed 27 February 2019
Christopher Hanks	Independent Non-Executive Director	
Richard Reid	Independent Non-Executive Director	
Fernand Grulms	Independent Non-Executive Director	Appointed 1 March 2019

According to the Register of Directors' Interests, no Director has any beneficial interest in the issued share capital of the Company.

Joseph Cassidy resigned as Company Secretary on 18 July 2018.

Results and dividends
The loss for the year after taxation is $18.8m (2017: loss $113.7m). No interim dividend was paid during the year (2017: $108,671).

Financial investments
Details of financial investments are set out in Note 9.

Tangible assets
The changes in the Company's tangible assets for the year are set out in Note 12.

Donations
During the year the Company made charitable donations of $40 (2017: $6,154) and made no political donations (2017: Nil).

Going concern
The Financial Statements have been prepared on a going concern basis. In assessing whether the going concern basis is appropriate, the Directors have considered the information contained in the Financial Statements, the Company's latest business plan, and the Company's current solvency calculations. The Directors are satisfied that the Company has adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the annual report and Financial Statements.

Disclosure of information to the Auditors
So far as each person who was a Director of the Company at the date of approving this report is aware, there is no relevant audit information, being information needed by the Company's auditor in connection with its report, of which the auditor is unaware. Having made enquiries of fellow Directors of the Company and the Company's Auditor, each Director has taken all the steps that he/she is obliged to

Directors' Report (continued)

take as a Director in order to make himself/herself aware of any relevant audit information and to establish that the auditor is aware of that information.

Subsequent events and Future developments
The Company has taken steps, as noted in the Strategic report, to minimise the uncertainly around Brexit in 2019. As the outcome of Brexit unfolds, the Company believes it is well positioned to deal with the both the leave and the extension scenarios.

The company re-domiciled to Luxembourg on 1 March 2019. As a result, the Company's accounts for the year ending 31 December 2019 will be prepared under Luxembourg GAAP. No material changes are expected between UK GAAP and Luxembourg GAAP.

The Company received a capital injection of $200m on 29 March 2019 to support the growth plans.

Auditors
The Company intends to re-appoint Ernst & Young LLP as the auditors of the Company at its Annual General Meeting. Ernst & Young LLP have expressed their willingness to continue in office and have been invited to do so.

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

Graham Brady
17 April 2019

Statement of Directors' Responsibilities

The Directors are responsible for preparing the Strategic Report, Directors' Report and the Financial Statements in accordance with applicable law and regulations. Whilst the Company is not required to produce financial statements under Companies Act, the Company has decided to voluntarily adopt the Companies Act in preparing these financial statements including the statements below.

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 law). The Financial Statements are required by law to give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing those 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 applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the Financial Statements; and
- Prepare the Financial Statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The Directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the Company. This also enables them to ensure that the Financial Statements comply with applicable rules. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation in the United Kingdom governing the preparation and dissemination of Financial Statements may differ from legislation in other jurisdictions.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF LIBERTY MUTUAL INSURANCE EUROPE SE

Opinion

We have audited the financial statements of Liberty Mutual Insurance Europe SE ('the Company') for the year ended 31 December 2018 which comprise the Income Statement, Statement of Other Comprehensive Income, Statement of Changes in Equity, Statement of Financial Position and the related notes 1 to 28 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 Financial Reporting Standard 103 "Insurance Contracts" (United Kingdom Generally Accepted Accounting Practice).

In our opinion, the financial statements:

- give a true and fair view of the Company's affairs as at 31 December 2018 and of its loss for the year then ended; and
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice including FRS 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland" and Financial Reporting Standard 103 "Insurance Contracts".

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)). Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of our report below. 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 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.

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 Company'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.

Overview of our audit approach

Key audit matters	• Valuation of the gross IBNR provisions for insurance liabilities
Materiality	• Overall materiality of $12.8m which represents 0.8% of Gross Written Premium

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF LIBERTY MUTUAL INSURANCE EUROPE SE (continued)

Key audit matters

Key audit matters are those matters that, in our professional judgment, 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) that we identified. These matters included 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 our opinion thereon, and we do not provide a separate opinion on these matters.

Risk	Our response to the risk	Key observations communicated to the Audit Committee
Valuation of the gross IBNR provisions for insurance liabilities (included within Claims Outstanding, Note 17) **(2018: $1.37bn, 2017: $1.18bn)** The valuation of gross provisions for insurance liabilities incorporates judgement for the expected ultimate cost of claims incurred, but not yet reported (IBNR), at the reporting date. It is reasonably possible that uncertainties inherent in the reserving process, delays in insurers reporting losses to the Company, together with the potential for adverse development, could lead to the ultimate amount paid varying materially from the amount estimated at this reporting date.	► We understood, assessed and tested the design and operational effectiveness of the key controls in the reserving process including the review and approval of the reserves, and controls over the extraction of data from the appropriate sources. ► Supported by our actuarial specialists we evaluated management's methodology against market practice and challenged management's assumptions and their assessment of major sensitivities, based on our market knowledge and industry data where available. The main areas of judgement include the level of reserves held for specific losses, the loss development patterns selected and the initial expected loss ratios. ► Using management's data we independently re-projected a proportion of the claims provisions investigating significant differences between our	Taken as a whole, we consider that management's judgements in the areas highlighted are reasonable based on the information available at the date of the report. The Company's provisions lie within what we consider to be a reasonable range of estimates. In addition, we consider that the disclosures made are satisfactory, and they provide information that assists in understanding the uncertainty inherent in the valuation of provisions for insurance liabilities.

	projections and management's booked reserves. Using our own re-projections, we then considered whether the provisions for insurance liabilities held at the year- end fall within a reasonable range of estimates. ► We have read the related disclosures and considered whether they satisfy the requirements of accounting standards.	

An overview of the scope of our audit

Tailoring the scope

Our assessment of audit risk, our evaluation of materiality and our allocation of performance materiality determine our audit scope for the Company. This enables us to form an opinion on the financial statements. We take into account size, risk profile, the organisation of the Company and effectiveness of controls, including controls and changes in the business environment when assessing the level of work to be performed.

The Company is a subsidiary of Liberty Mutual Company Inc. which is based in the United States of America. Subsidiaries of Liberty Mutual Group operate centralised Investments, Reinsurance and IT functions benefiting the subsidiaries.

In establishing the overall approach to the Company audit, we determined the type of work that needed to be performed by us, as the Company engagement team, or other EY network firms, operating under our direction and oversight. EY US performed audit procedures over investments and IT, EY Canada performed audit procedures over reinsurance. Where the work was performed by an EY network firm, we determined the level of involvement we needed to have in the audit work to be able to conclude whether sufficient appropriate audit evidence had been obtained.

The Audit Engagement Partner and senior members of the audit team reviewed the work performed by the EY network firms. This, together with audit procedures performed by us, gave us the evidence we needed for our opinion on the Company's financial statements.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF LIBERTY MUTUAL INSURANCE EUROPE SE (continued)

In assessing the risk of material misstatement to the financial statements, and to ensure we had adequate quantitative coverage of significant accounts in the financial statements, we performed audit procedures related to Liberty Mutual Insurance Europe Limited's branches as noted below. In doing so, we also considered qualitative factors and checked we obtained sufficient coverage across all financial statements line items in the financial statements. This scope provided us with coverage of more than 90% of gross written premium.

Details of the branch financial information audited by us are:

Branch	Scope	Auditor
LMIE London	Full	EY London
LMIE Paris	Full	EY London

Changes from the prior year

We have removed the Hong Kong branch from scope, as a result of its closure in 2017.

Our application of materiality

We apply the concept of materiality in planning and performing the audit, in evaluating the effect of identified misstatements on the audit and in forming our audit opinion.

Materiality
The magnitude of an omission or misstatement that, individually or in the aggregate, could reasonably be expected to influence the economic decisions of the users of the financial statements. Materiality provides a basis for determining the nature and extent of our audit procedures.

We determined materiality for the Company to be $12.8 million (2017: $10 million), which is 0.8% (2017: 0.8%) of Gross Written Premium. Because of the potential variability in the Company's results, we believe that Gross Written Premium provides us with a measurement of materiality which is most closely aligned to the key focus of the entity and its users of the financial statements.

Performance materiality
The application of materiality at the individual account or balance level. It is set at an amount to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality.

On the basis of our risk assessments, together with our assessment of the Company's overall control environment, our judgement was that performance materiality was 50% (2017: 75%) of our planning materiality, namely $6.4m (2017: $7.5m). We reduced the percentage to 50% due to changes in the Company's processes and systems during the year.

Reporting threshold
An amount below which identified misstatements are considered as being clearly trivial.

We agreed with the Audit Committee that we would report to them all uncorrected audit differences in excess of $0.6m (2017: $0.5m), which is set at 5% of planning materiality, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF LIBERTY MUTUAL INSURANCE EUROPE SE (continued)

We evaluate any uncorrected misstatements against both the quantitative measures of materiality discussed above and in light of other relevant qualitative considerations in forming our opinion.

Other information

The other information comprises the information included in the annual report set out on pages 4 to 11, other than the financial statements and our auditor's report thereon. The directors are responsible for the other information.

Our opinion on the financial statements does not cover the other information and, 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 the other information, we are required to report that fact.

We have nothing to report in this regard.

Responsibilities of directors

As explained more fully in the directors' responsibilities statement set out 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 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.

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.

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; and to respond appropriately to fraud or suspected fraud identified during the audit.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF LIBERTY MUTUAL INSURANCE EUROPE SE (continued)

However, the primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management; and in respect of irregularities, considered to be non-compliance with laws and regulations, are to obtain sufficient appropriate audit evidence regarding compliance with the provisions of those laws and regulations generally recognised to have a direct effect on the determination of material amounts and disclosures in the financial statements ('direct laws and regulations'), and perform other audit procedures to help identify instances of non-compliance with other laws and regulations that may have a material effect on the financial statements. We are not responsible for preventing non-compliance with laws and regulations and our audit procedures cannot be expected to detect non-compliance with all laws and regulations.

Our approach was as follows:

- We obtained an understanding of the legal and regulatory frameworks that are applicable to the Company and determined that the most significant frameworks which are directly relevant to specific assertions in the financial statements are those that relate to the reporting framework (FRS 102, FRS 103) and the relevant tax compliance regulations in the UK and overseas jurisdictions in which the Company operates. Our considerations of other laws and regulations that may have a material effect on the financial statements included the permissions and supervisory requirements of the Prudential Regulation Authority ('PRA') and the Financial Conduct Authority ('FCA').
- We obtained a general understanding of how the Company complies with these legal and regulatory frameworks by making enquiries of management, internal audit, and those responsible for legal and compliance matters. We also reviewed correspondence between the Company and UK regulatory bodies; reviewed minutes of the board; and gained an understanding of the Company's approach to governance.
- We assessed the susceptibility of the Company's financial statements to material misstatement, including how fraud might occur, by meeting with management within various parts of the business to understand where they considered there was susceptibility to fraud. Where the risk was considered to be higher, we performed audit procedures to address each identified fraud risk. These procedures included testing manual journals and were designed to provide reasonable assurance that the financial statements were free from fraud or error.
- For direct laws and regulation, we considered the extent of compliance with those laws and regulations as part of our procedures on the related financial statement items.
- For both direct and other laws and regulations, our procedures included review of board minutes, a review of the reporting to the Audit Committee on compliance with regulations and enquiries of management.
- The Company operates in the insurance industry which is a highly regulated environment. As such the lead audit partner considered the experience and expertise of the engagement team to ensure that the team had the appropriate competence and capabilities, which included the use of specialists where appropriate.

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

Other matters we are required to address

- We were appointed as auditor by the Company to audit the financial statements for the year ending 31 December 1996 and for all subsequent financial periods. The period of total uninterrupted engagement, including previous renewals and reappointments is 23 years, covering the years ending 31 December 1996 to 31 December 2018.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF LIBERTY MUTUAL INSURANCE EUROPE SE (continued)

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

- The audit opinion is consistent with the additional report to the audit committee

Use of our report

This report is made solely to the Company's members, as a body, in accordance with our engagement letter dated 16 April 2019. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Ernst & Young LLP

Ernst & Young LLP
London
18 April 2019

Notes:

1. The maintenance and integrity of the Liberty Mutual Insurance Europe SE web site is the responsibility of the directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the web site.
2. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Income Statement: Technical Account - General Business

for the year ended 31 December 2018

	Notes	2018 $000	2017 $000
Gross premiums written	2	1,601,356	1,250,662
Outward reinsurance premiums		(530,283)	(490,942)
Net premiums written		**1,071,073**	**759,720**
Change in the provision for unearned premiums:			
Gross amount		(337,910)	(154,464)
Reinsurers' share		93,705	37,246
Change in net provision for unearned premiums		**(244,205)**	**(117,218)**
Earned premiums, net of reinsurance		**826,868**	**642,502**
Allocated investment return transferred from the non-technical account	3	48,298	27,810
Claims incurred, net of reinsurance:			
Claims paid			
Gross amount	17	(606,808)	(509,236)
Reinsurers' share	17	226,087	166,575
Net claims paid		**(380,721)**	**(342,661)**
Change in provision for claims:			
Gross amount		(156,876)	(385,987)
Reinsurers' share		1,047	194,744
Change to the net provision for claims		**(155,829)**	**(191,243)**
Claims incurred net of reinsurance		**(536,550)**	**(533,904)**
Net operating expenses	4	(338,238)	(246,726)
Balance on the Technical account for General Business		**378**	**(110,318)**

The notes on pages 25 to 67 form part of these accounts.

Income Statement: Non-Technical Account - General Business

for the year ended 31 December 2018

	Notes	2018 $000	2017 $000
Balance on the Technical account for General Business		378	(110,318)
Investment income and gains on realisation of investments	3	53,334	32,703
Unrealised (losses)/gains on investments	3	(424)	955
Investment expenses and charges	3	(3,208)	(3,236)
Allocated investment return transferred to the general business technical account	3	(48,298)	(27,810)
Exchange losses		(8,764)	(17,866)
Loss on ordinary activities before tax		**(6,982)**	**(125,572)**
Tax on loss on ordinary activities	7	(11,857)	11,890
Loss on ordinary activities after tax		**(18,839)**	**(113,682)**

The notes on pages 25 to 67 form part of these accounts.

Statement of Comprehensive Income

for the year ended 31 December 2018

	Notes	2018 $000	2017 $000
Loss on ordinary activities after tax		(18,839)	(113,682)
Fair value gains/(losses) recognised during the year on available for sale investments net of tax		(39,818)	22,444
Re-measurement of the net defined benefit surplus	**21**	1,111	1,673
Deferred tax relating to re-measurement of the net defined benefit asset	**7**	161	(938)
Total comprehensive loss for the year		**(57,385)**	**(90,503)**

The notes on pages 25 to 67 form part of these accounts.

Statement of Changes in Equity
for the year ended 31 December 2018

2018	Called up share capital $000	Share premium account $000	Available for sale reserve $000	Profit and loss account $000	Total $000
At 1 January 2018	290,239	100,000	21,126	520,374	**931,739**
Shares issued for cash	30	360,000	-	-	**360,030**
Dividends paid	-	-	-	-	**-**
Total comprehensive loss for the year	-	-	(39,818)	(17,567)	**(57,385)**
At 31 December	290,269	460,000	(18,692)	502,807	**1,234,384**

2017	Called up share capital $000	Share premium account $000	Available for sale reserve $000	Profit and loss account $000	Total $000
At 1 January 2017	290,225	100,000	(1,318)	633,430	**1,022,337**
Shares issued for cash	14	-	-	-	**14**
Dividends paid	-	-	-	(109)	**(109)**
Total comprehensive loss for the year	-	-	22,444	(112,947)	**(90,503)**
At 31 December	**290,239**	**100,000**	**21,126**	**520,374**	**931,739**

The notes on pages 25 to 67 form part of these accounts.

Statement of Financial Position - Assets
at 31 December 2018

	Notes	2018 $000	2017 $000
Investments			
Investments in subsidiary undertakings	**8**	-	5
Financial investments	**9**	2,594,794	2,369,306
Deposits with ceding undertakings		59,453	32,497
		2,654,247	2,401,808
Reinsurers' share of technical provisions			
Provision for unearned premiums	**16**	373,931	285,434
Claims outstanding	**17**	890,217	912,708
		1,264,148	1,198,142
Debtors			
Debtors arising out of direct insurance operations - intermediaries		345,229	376,202
Debtors arising out of reinsurance operations	**10**	586,699	260,443
Other debtors	**11**	52,434	20,003
		984,362	656,648
Other assets			
Tangible assets	**12**	6,219	9,825
Cash at bank and in hand		295,970	174,066
		302,189	183,891
Prepayments and accrued income			
Gross deferred acquisition costs	**13**	329,028	251,651
Other prepayments and accrued income		28,029	27,977
		357,057	279,628
Total assets excluding pension assets		5,562,003	4,720,117
Pension surplus	**21**	8,943	8,119
Total assets		**5,570,946**	**4,728,236**

The notes on pages 25 to 67 form part of these accounts.

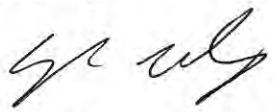
Statement of Financial Position - Liabilities

at 31 December 2018

	Notes	2018 $000	2017 $000
Capital and reserves			
Called up share capital	**14**	290,269	290,239
Share premium account	**15**	460,000	100,000
Available for sale reserve	**15**	(18,692)	21,126
Profit and loss account		502,807	520,374
		1,234,384	931,739
Technical provisions			
Provision for unearned premiums	**16**	1,256,249	947,557
Gross claims outstanding	**17**	2,546,927	2,469,348
		3,803,176	3,416,905
Other provisions	**20**	125	946
Creditors			
Creditors arising out of direct insurance operations		26,606	7,250
Creditors arising out of reinsurance operations	**18**	281,806	191,085
Other creditors including taxation and social security	**19**	64,797	71,479
		373,209	269,814
Accruals and deferred income		160,052	108,832
Total equity and liabilities		**5,570,946**	**4,728,236**

The notes on pages 25 to 67 form part of these accounts.

The Financial Statements were approved by the Board of Directors on 17 April 2019 and were signed on its behalf by:



Graham Brady
Director

Notes to the Financial Statements
for the year ended 31 December 2018

1. Accounting Policies

1.1 Statement of compliance

Liberty Mutual Insurance Europe SE (formerly Liberty Mutual Insurance Europe Limited – UK Companies House registered number 01088268) is a limited liability company incorporated in the Grand Duchy of Luxembourg, registered office details are on page 3. The Company changed its domicile from the UK to Luxembourg effective 1 March 2019.

The Financial Statements cover those of the individual entity and are prepared as at, and for the year ended, 31 December 2018.

The Company has voluntarily decided to prepare these Financial Statements in accordance with FRS 102 and FRS 103, being the applicable UK GAAP accounting standards, and in accordance with the provisions of Schedule 3 of the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (The Regulations) relating to insurance companies. The Company's accounts for the year ending 31 December 2019 will be prepared under Luxembourg GAAP.

The Financial Statements are prepared under the historical cost convention except for financial investments which are measured at fair value and the defined benefit pension obligation which is measured under the projected unit credit method.

1.2 Basis of preparation

The Financial Statements for the year ended 31 December 2018 were approved for issue by the Board of Directors on 17 April 2019.

The Financial Statements are prepared in United States Dollar which is the presentation and functional currency of the Company and rounded to the nearest $'000, unless otherwise stated.

The Company has elected to apply paragraph 6.3 of FRS 103 to claims development triangles where the Company need not disclose information that occurred earlier than five years before the end of the first financial year in which this FRS applies, building up to 10 years of development with the introduction of each future period. Claims development triangles are reported on an underwriting year basis.

The consolidated Financial Statements of Liberty International Holdings Incorporated (DE) are prepared in accordance with US GAAP and are available to the public.

The Company is considered to be a qualifying entity (for the purposes of this FRS) and has applied the exemptions available under FRS 102 in respect of the following disclosures:

- FRS 102 Section 3 Financial Statement [4.12 (a)(iv)] and Section 7 Statement of Cash Flows: Cash Flow Statement and related notes
- FRS 102 Section 4 Statement of Financial Position [3.17(d)]: Reconciliation of the number of shares outstanding from the beginning to end of the period
- FRS 102 Section 33 Related Party Disclosures [33.7]: Related party transactions with key management personnel compensation

The Company has taken advantage of the exemption under FRS 102 Section 33 Related party Disclosures [33.1A] to not disclose related party transactions with wholly owned subsidiaries of Liberty International Holdings Incorporated (DE).

The accounting policies set out below have, unless otherwise stated, been applied consistently to all periods presented in these Financial Statements.

Notes to the Financial Statements (continued)

1. Accounting Policies (continued)

1.3 Judgements and key sources of estimation uncertainty

The preparation of the Financial Statements requires management to make judgements, estimates and assumptions that affect the amounts reported for assets and liabilities as at the balance sheet date and the amounts reported for revenues and expenses during the year. However, the nature of estimation means that actual outcomes could differ from those estimates.

1.3.1 Technical provisions

For insurance contracts, estimates have to be made both for the expected ultimate cost of claims reported at the reporting date and for the expected ultimate cost of claims incurred, but not yet reported (IBNR), at the reporting date. It can take a significant period of time before the ultimate claims cost can be established with certainty and for some type of policies, IBNR claims form the majority of the liability in the statement of financial position.

The ultimate cost of outstanding claims is estimated by using a range of standard actuarial claims projection techniques, such as Chain Ladder and Bornhuetter-Ferguson methods. The main assumption underlying these techniques is that past claims development experience can be used to project future claims development and hence ultimate claims costs. As such, these methods extrapolate the development of paid and incurred losses based on the observed development of earlier years and expected loss ratios. Historical claims development is mainly analysed by underwriting years by significant lines of business. Large / catastrophe claims are usually separately addressed, either by being reserved at the face value of loss adjuster estimates or separately projected in order to reflect their future development. In most cases, no explicit assumptions are made regarding future rates of claims inflation or loss ratios. Instead, the assumptions used are those implicit in the historical claims development data on which the projections are based.

Additional qualitative judgement is used to assess the extent to which past trends may not apply in future (e.g. to reflect one-off occurrences, changes in external or market factors such as public attitudes to claiming, economic conditions, levels of claims inflation, judicial decisions and legislation, as well as internal factors such as portfolio mix, policy features and claims handling procedures), in order to arrive at the estimated ultimate cost of claims that present the likely outcome from the range of possible outcomes, taking account of all the uncertainties involved.

Further details are given in Note 17.

1.3.2 Estimates of future premiums

For certain insurance contracts, premium is initially recognised based on estimates of ultimate premiums. These estimates are judgemental and could result in mis-statements of revenue recorded in the Financial Statements. The main assumption underlying these estimates is that past premium development can be used to project future premium development.

1.3.3 Fair value of financial assets determined using valuation techniques

Where the fair value of financial assets recorded on the statement of financial position cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of discounted cash flow models and/or other mathematical models.

Notes to the Financial Statements (continued)

1. Accounting Policies (continued)

1.3 Judgements and key sources of estimation uncertainty (continued)

1.3.3 Fair value of financial assets determined using valuation techniques (continued)

The inputs from these models are derived from observable market data where possible, but where observable market data are not available, judgement is required to establish fair values. For fixed income and asset backed securities the judgements include considerations for liquidity risk, credit risk, and prepayment rates.

For discounted cash flow analysis, estimated future cash flows and discount rates are based on current market information and rates applicable to financial instruments with similar yields, credit quality and maturity characteristics. Estimated future cash flows are influenced by factors such as economic conditions (including country specific risks), concentrations of specific industries and market liquidity. Discount rates are influenced by risk free interest rates and credit risk.

Changes in the assumptions about these factors could affect the reported fair value of the financial instruments. Further details are given in Note 9.

1.3.4 Defined benefit pension scheme

The cost of the defined benefit pension plan is based on assumptions determined with the assistance of external actuarial advice. The key assumptions impacting the valuations are the discount rate, inflation and mortality rates. The principal assumptions used by the independent qualified actuaries to calculate the liabilities under FRS 102 are detailed in Note 21. Refer to Note 21 for further details about the Company's defined benefit pension plan costs and obligations.

1.3.5 Taxation

The Company establishes provisions based on reasonable estimates, for possible consequences of audits by the tax authorities of the respective countries in which it operates. The amount of such provisions is based on various factors, such as experience with previous tax audits and differing interpretations of tax regulations by the tax authority.

Management estimation is required to determine the amount of deferred tax assets that can be recognised, based upon likely timing and level of future taxable profits together with an assessment of the effect of future tax planning strategies. Further details are given in Note 7.

1.4 Significant accounting policies

1.4.1 Financial Investments

As permitted by FRS 102, the Company has elected to apply the recognition and measurement provisions of IAS 39 Financial Instruments: recognition and measurement (as adopted for use in the EU) to account for all of its financial instruments.

The Company classifies its financial assets into the following categories: Shares and other variable-yield securities - at fair value through profit or loss; Debt securities and other fixed-income securities, Deposits with credit institutions – available for sale and other financial investments – Loans and receivables.

The Company determines the classification of its financial assets on initial recognition.

Available for sale

Non-derivative financial assets that are not classified as designated at fair value through profit or loss or loans and receivables are classified as available-for-sale.

Notes to the Financial Statements (continued)

1. Accounting Policies (continued)

1.4 Significant accounting policies (continued)

1.4.1 Financial Investments (continued)

Changes in fair value are recognised in other comprehensive income and as a separate component in equity, except for interest (which is recognised in income on an effective yield basis), impairment losses and foreign exchange gains or losses, until the investment is derecognised or the investment is determined to be impaired. On de-recognition or impairment, the cumulative fair value gains and losses previously reported through other comprehensive income are transferred to the income statement.

Debt securities and other fixed interest securities are reviewed for any permanent diminution in value periodically on a holding by holding basis. Where a permanent diminution is identified, an impairment is recognised as a realised investment loss in the income statement.

Deposits with credit institutions are also classified as available for sale and are held at cost as the best measure for fair value. These typically consist of callable on-demand deposits with very short maturities, which are not always held to maturity.

Financial assets at fair value through profit or loss

Shares and other variable yield securities consist of collective investment schemes and private equity investments.

A financial asset is classified into this category at inception if they are acquired principally for the purpose of selling in the short term, if they form part of a portfolio of financial assets in which there is evidence of short term profit-taking, or if so designated by management to minimise any measurement or recognition inconsistency with the associated liabilities.

The fair values of financial instruments traded in active markets are based on quoted bid prices on the balance sheet date. A market is regarded as active if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service, or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis.

The fair values of financial instruments that are not traded in an active market, are established by the directors using valuation techniques which seek to arrive at the price at which an orderly transaction would take between market participants.

Net gains or losses arising from changes in the fair value of financial assets at fair value through profit or loss are presented in the profit and loss account within 'Unrealised gains on investments' or 'Unrealised losses on investments' in the period in which they arise.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market other than those that the Company intends to sell in the short term or that it has designated as at fair value through profit and loss. When a financial asset is recognised initially it is measured at fair value less transaction costs that are directly attributable to the acquisition of the financial asset. Loans and receivables are subsequently measured at amortised cost using the effective interest method. Receivables arising from insurance contracts are also classified in this category and are reviewed for impairment as part of the impairment review of loans and receivables.

Offsetting of financial instruments

Financial assets and financial liabilities are offset and the net amount is reported in the statement of financial position if, and only if there is a current enforceable legal right to offset the recognised amounts and there is an intention to settle on a net basis, realise the assets and settle the liabilities simultaneously.

Notes to the Financial Statements (continued)

1. Accounting Policies (continued)

1.4 Significant accounting policies (continued)

1.4.2 Cash and Cash Equivalents

Cash and cash equivalents in the balance sheet comprise cash at banks and in hand and short-term deposits with an original maturity date of three months or less.

1.4.3 Fair value of financial assets

The Company uses the following hierarchy for determining the fair value of financial instruments by valuation technique:

- Level 1: the unadjusted quoted prices in an active market for identical assets or liabilities. Quoted in an active market in this context means quoted prices are readily and regularly available and those prices represent actual and regularly occurring market transactions on an arm's length basis. The quoted price is usually the bid price.

- Level 2: when quoted prices are unavailable the instrument is valued using inputs that are observable either directly or indirectly including quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in inactive markets.

- Level 3: when observable inputs are not available, unobservable inputs are used to measure fair value by use of valuation techniques. The objective of using the valuation technique is to estimate what the fair value would have been on the measurement date.

See note 9 for details of financial instruments classified by fair value hierarchy.

1.4.4 Impairment of financial assets

Available for sale

If an available for sale financial asset is impaired, an amount comprising the difference between its cost (net of any principal repayment and amortisation) and its current fair value, less any impairment loss previously recognised in the profit and loss account, is transferred from other comprehensive income in equity to the profit and loss account. Reversals of impairment losses on debt instruments classified as available for sale are reversed through the profit and loss account, if the increase in the fair value of the instruments can be objectively related to an event occurring after the impairment losses were recognised in the profit and loss account.

Loans and receivables

For assets carried at cost, if there is objective evidence that an impairment loss on an investment that is not carried at fair value, because its fair value cannot be reliably measured, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows discounted at the current market rate of return of a similar asset.

1.4.5 Derecognition of financial assets

A financial asset or, when applicable, a part of a financial asset is derecognised when:

- The rights to the cash flows from the asset have expired; or
- The company retains the right to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full without material delay to a third party under a 'pass through' arrangement and either (a) the company has transferred substantially all the risks and rewards of the asset; or (b) the company has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

Notes to the Financial Statements (continued)

1. Accounting Policies (continued)

1.4 Significant accounting policies (continued)

1.4.5 Derecognition of financial assets (continued)

When the company has transferred its right to receive cash flows from an asset or has entered into a pass-through arrangement, and has neither transferred nor retained substantially all the risks and rewards nor transferred control of the asset, the asset is recognised to the extent of the company's continuing involvement in the asset. Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the company could be required to repay. In that case, the company also recognises an associated liability.

1.4.6 Investment Return

Investment return comprises all investment income, realised investment gains and losses and movements in unrealised investment gains and losses, net of investment expenses, charges and interest.

Dividends are recognised when the investments to which they relate are declared 'ex-dividend'. In accordance with FRS 102 29.19 Income Tax, dividends are recognised at the amount receivable including withholding tax if applicable, but excluding any attributable tax credit.

Unrealised and realised gains and losses on financial investments are recognised based on the appropriate classification of financial investments and are covered in detail under the accounting policy for financial investments. See note 3 for further details on investment return.

An allocation of actual investment return on investments supporting the general insurance technical provisions and associated equity is made from the non-technical account to the technical account. Investment return related to non-insurance business and shareholders' equity is attributed to the non-technical account.

1.4.7 Financial Liabilities

The Company's financial liabilities consist of insurance creditors, intercompany balances and trade payables.

All financial liabilities are recognised initially at fair value. Intercompany balances are repayable on demand and are typically settled within one year. Intercompany balances are subsequently measured at amortised cost should they remain unsettled over a year. A financial liability is derecognised when the obligation under the liability is discharged or expires.

Insurance Contracts

1.4.8 Product Classification

Insurance contract are those contracts when the Company (the insurer) has accepted significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholders. As a general guideline, the Company determines whether it has significant insurance risk, by comparing benefits paid with benefits payable if the insured event did not occur. Insurance contracts can also transfer financial risk.

Once a contract has been classified as an insurance contract, it remains an insurance contract for the remainder of its lifetime, even if the insurance risk reduces significantly during this period, unless all rights and obligations are extinguished or expire.

Notes to the Financial Statements (continued)

1. Accounting Policies (continued)

1.4 Significant accounting policies (continued)

1.4.9 Premiums

Gross written premiums comprise the total premiums receivable for the whole period of cover provided by the contracts entered into during the reporting period, regardless of whether these are wholly due for payment in the reporting period, together with any adjustments arising in the reporting period to such premiums receivable in respect of business written in prior reporting periods. They are recognised on the date on which the policy commences. Additional or return premiums are treated as a re-measurement of the initial premium. Gross written premiums are stated gross of commission.

Written premiums include an estimate for pipeline premiums (i.e. premiums written but not reported to the Company by the reporting date) relating only to those underlying contracts of insurance where the period of cover has commenced prior to the reporting date. The most significant assumption in this estimate is that prior year experience will be consistent with current experience.

Under some policies, written premiums are adjusted retrospectively in the light of claims experience or where the risk covered cannot be assessed accurately at the commencement of cover. Where written premiums are subject to an increase retrospectively, recognition of any potential increase is deferred until the additional amount can be ascertained with reasonable certainty. Where written premiums are subject to a reduction, a re-measurement taking account of such a reduction is made as soon as there is an obligation to the policyholder.

Written premiums are earned over the period of the policy (usually 12 months) on a straight-line basis except for certain inwards reinsurance contracts where there is a marked unevenness in the incidence of risk over the period of cover, in which case the premium is earned on a basis which reflects the profile of risk.

Outward reinsurance premiums are accounted for in the same accounting period as the premiums for the related direct insurance or inwards reinsurance business.

1.4.10 Fee and Commission Income

Insurance policyholders are charged for policy administration services, investment management services, surrenders and other contract fees. These fees are recognised as revenue over the period in which the related services are performed. If the fees are for services provided in future periods, then they are deferred and recognised over those future periods.

1.4.11 Claims

Claims include all claims occurring during the year, whether reported or not, related internal and external claims management costs that have been determined by an apportionment of employment costs, and any adjustments to claims outstanding from previous years.

Internal claims handling costs, including remuneration costs of the claims department, are re-classified from administrative expenses and included in claims incurred.

Reinsurance claims are predominantly recognised when the related gross insurance claim is recognised according to the terms of the relevant contract.

Technical Provisions

Technical provisions comprise claims outstanding, provisions for unearned premiums and provisions for unexpired risk.

Notes to the Financial Statements (continued)

1. Accounting Policies (continued)

1.4 Significant accounting policies (continued)

1.4.12 Claims Outstanding

Provision is made on an individual case basis for the estimated cost of claims notified but not settled by the balance sheet date after taking into account handling costs and settlement trends. A provision for claims incurred but not reported is established from statistical analysis undertaken by the Company's actuaries. The methods used and the estimates made are reviewed regularly.

Whilst the Directors consider that the gross provision for claims and the related reinsurance recoveries are fairly stated on the basis of the information currently available to them, the ultimate liability will vary as a result of subsequent information and events. Any differences between provisions and subsequent settlements are dealt with in the technical accounts of later years.

In calculating the estimated cost of unpaid claims the Company uses a variety of estimation techniques, generally based upon statistical analyses of historical experience, which assumes that the development pattern of current claims will be consistent with past experience.

Allowance is made, however, for changes or uncertainties which may create distortions in the underlying statistics or which may cause the cost of unsettled claims to change when compared with the cost of previously settled claims including:

- changes in Company processes which might accelerate or slow down the development and/or recording of paid or incurred claims compared with the statistics from previous periods;
- changes in the legal environment;
- the effects of inflation;
- changes in the mix of business;
- the impact of large losses;
- movement in industry benchmarks.

A component of these estimation techniques is usually the estimation of the cost of notified but not paid claims. In estimating the cost of these, the Company has regard to claim circumstances as reported, and information available from loss adjusters and information on the cost of settling claims with similar characteristics in previous periods.

Large claims impacting each relevant business class were assessed separately where appropriate, being measured on a case-by-case basis or projected separately in order to allow for the possible distortive effect of the development and incidence of the large claims.

The provision for claims outstanding is based on information available at the balance sheet date and it is estimated to give a result within a normal range of outcomes. To the extent that the ultimate cost falls outside this range, for example where assumptions over claims inflation may alter in future, there is a contingent liability in respect of this uncertainty. Provisions are calculated allowing for reinsurance recoveries and a separate asset is recorded for the reinsurers' share, having regard to collectability.

The reinsurers' share of provisions for claims is based on the amounts of outstanding claims and projections for IBNR, net of estimated irrecoverable amounts, having regard to the reinsurance programme in place for the class of business, the claims experience for the year, and the current security rating of the reinsurance companies involved.

Notes to the Financial Statements (continued)

1. Accounting Policies (continued)

1.4 Significant accounting policies (continued)

1.4.12 Claims Outstanding (continued)

Anticipated salvage and subrogation recoveries are calculated on an individual case basis. The level of recovery estimated is set on the basis of information which is currently available, including potential outstanding claims advices and case law. Salvage and subrogation recoveries are included in claims incurred in the income statement.

The liability is not discounted for the time value of money.

1.4.13 Provisions for unearned premiums

Unearned insurance and inward reinsurance premiums are those proportions of premiums written in a year that relate to periods of risk after the reporting date. Unearned insurance and inward reinsurance premiums are deferred over the term of the underlying direct insurance policies for risks-attaching contracts and over the term of the reinsurance contract for losses-occurring contracts. The provision for unearned premiums is calculated on a daily pro rata basis. The proportion attributable to subsequent periods is deferred as a provision for unearned premiums.

Unearned outward reinsurance premiums are deferred over the term of the underlying insurance policies covered by the contract.

1.4.14 Provisions for unexpired risks

Provision is made where the cost of claims and expenses arising after the end of the financial year from contracts concluded before that date, is expected to exceed the provision for unearned premiums, net of deferred acquisition costs. The overall assessment of whether a provision is necessary is made on the basis of all categories of business. No account is taken of future investment income.

At 31 December 2018 and 31 December 2017 the Company did not have an unexpired risks provision.

1.4.15 Deferred acquisition costs

Commission costs and other costs directly related and incremental to successful acquisition activities which vary with, and are primarily related to, the acquisition of new insurance contracts and the renewal of existing insurance contracts are deferred to the extent that they are attributable to premiums unearned at the balance sheet date. Deferred acquisition costs are amortised over the period in which the related premiums are earned.

Commissions receivable on outwards reinsurance contracts are deferred and amortised over the term of the expected premiums payable. Amortisation is reported in the technical account.

1.4.16 Reinsurance assets

The Company cedes insurance risk in the normal course of business. Reinsurance assets represent balances due from reinsurance companies. Amounts recoverable from reinsurers are estimated in a manner consistent with the outstanding claims provision or settled claims associated with the reinsurer's policies and are in accordance with the related reinsurance contract.

Reinsurance assets are reviewed for impairment at each reporting date, or more frequently, when an indication of impairment arises during the reporting year. Impairment occurs when there is objective evidence as a result of an event that occurred after initial recognition of the reinsurance asset that the Company may not receive all outstanding amounts due under the terms of the contract, and the event has a reliably measurable impact on the amounts that the Company will receive from the reinsurer. The impairment loss is recorded in the income statement.

Notes to the Financial Statements (continued)

1. Accounting Policies (continued)

1.4 Significant accounting policies (continued)

1.4.17 Insurance receivables

Insurance receivables are recognised when due and measured on initial recognition at the fair value of the consideration received or receivable. Subsequent to initial recognition, insurance receivables are measured at amortised cost, using the effective interest rate method. The carrying value of insurance receivables is reviewed for impairment whenever events or circumstances indicate that the carrying amount may not be recoverable, with the impairment loss recorded in the statement of profit or loss.

Insurance receivables are derecognised when the de-recognition criteria for financial assets have been met.

1.4.18 Insurance payables

Insurance payables are recognised when due and measured on initial recognition at the fair value of the consideration received less directly attributable transaction costs. Subsequent to initial recognition, they are measured at amortised cost using the effective interest rate method. Insurance payables are derecognised when the obligation under the liability is settled, cancelled or expired.

1.4.19 Tangible fixed assets

Tangible fixed assets are stated at cost less accumulated depreciation and accumulated impairment losses.

The Company assesses at each reporting date whether tangible fixed assets are impaired.

Depreciation is charged to the profit and loss account at rates calculated over the estimated useful economic lives of the assets on a straight-line basis.

The periods used to depreciate such assets are as follows:

Leasehold improvements	Remaining lease term
Software	3 years
Computer Equipment	3 years
Motor Vehicles	4 years
Fixture, fittings and office equipment	5 to 10 years

Expenditure on leasehold improvements, software, computer equipment, motor vehicles, fixtures, fittings and office equipment is capitalised and depreciated over the estimated useful economic life of the assets on a straight-line basis.

1.4.20 Leases

Assets held under finance leases and hire purchase contracts are capitalised at their fair value on the inception of the leases and depreciated over their estimated useful lives. The finance charges are allocated over the period of the lease in proportion to the capital amount outstanding. Rentals under operating leases are charged to the income statement in equal annual instalments over the period of the lease.

1.4.21 Provisions

Provisions are recognised when the Company has a present obligation (legal or constructive) as a result of a past event, and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.

Notes to the Financial Statements (continued)

1. Accounting Policies (continued)

1.4 Significant accounting policies (continued)

1.4.22 Pension Benefits

The Company operates a defined benefit pension scheme, which requires contributions to be made to separately administered funds. The scheme was closed to new members in July 2003 from which time membership of a defined contribution plan was, and remains, available.

Employees joining on or after 1 January 2002 became members of the Company defined contribution pension schemes. Contributions to the defined contribution scheme are recognised in the income statement in the period in which they become payable.

Defined Benefit Pension Scheme

FRS 102 requires that all past service costs are recognised immediately. The cost of providing benefits under the defined benefit plans is determined using the projected unit credit method, which attributes entitlement to benefits to the current period (to determine current service cost) and to the current and prior periods (to determine the present value of defined benefit obligations) and is based on actuarial advice. When a settlement or a curtailment occur the change in the present value of the scheme liabilities and the fair value of the plan assets reflects the gain or loss which is recognised in the income statement during the period in which it occurs. Losses and gains are recognised in the income statement during the period in which the change happens.

The net interest element is determined by multiplying the net defined benefit liability by the discount rate, both determined at the start of the period taking into account any changes in the net defined benefit liability during the period as a result of contribution and benefit payments. The net interest is recognised in profit or loss.

Re-measurements, comprising actuarial gains and losses, the effect of the asset ceiling and the return on the net defined benefit liability (excluding amounts included in net interest) are recognised immediately in other comprehensive income in the period in which they occur. Re-measurements are not reclassified to profit and loss in subsequent periods.

The defined net benefit pension asset or liability in the balance sheet comprises the total of the present value of the defined benefit obligation (using a discount rate based on high quality corporate bonds), less the fair value of plan assets out of which the obligations are to be settled directly. Fair value is based on market price information and in the case of quoted securities is the published bid price. The value of a net pension benefit asset is limited to the amount that may be recovered either through reduced contributions or agreed refunds from the scheme.

Contributions to the defined contribution scheme are recognised in the profit and loss account in the period in which they become payable.

The pension scheme balance is recognised gross of any related deferred tax balance, with the related deferred tax item included in the wider deferred tax assets and liabilities.

1.4.23 Foreign currency

The Company has determined USD as its functional currency and has adopted USD as the presentational currency.

Transactions denominated in currencies other than the functional currency are initially recorded in the functional currency at the exchange rate ruling at the date of the transactions, or an appropriate average rate.

Notes to the Financial Statements (continued)

1. Accounting Policies (continued)

1.4 Significant accounting policies (continued)

1.4.23 Foreign currency (continued)

Monetary assets and liabilities (which include all assets and liabilities from insurance contracts including unearned premiums and deferred acquisition costs) denominated in foreign currencies are re-translated into the functional currency at the exchange rate ruling on the reporting date. Non-monetary items denominated in a foreign currency, measured at fair value are translated into the functional currency using the exchange rate ruling at the date when the fair value was determined.

Exchange differences are recorded in the non-technical account.

1.4.24 Taxation

Taxation expense for the period comprises current and deferred tax recognised in the reporting period.

Tax is recognised in the income statement, except to the extent that it relates to items recognised in other comprehensive income or directly in equity. In this case tax is recognised either in other comprehensive income or directly in equity as appropriate.

Current or deferred taxation assets and liabilities are not discounted.

Current tax

Current tax liabilities are measured at the amount of corporate income tax expected to be paid to or recovered from taxation authorities in respect of the taxable profit for the year or prior years. Tax is calculated on the basis of tax rates and laws that have been enacted or substantively enacted at the balance sheet date.

Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation. It establishes provisions where appropriate on the basis of amounts expected to be paid to the tax authorities.

Deferred tax

Deferred tax arises from timing differences that are differences between taxable profits and total comprehensive income as stated in the Financial Statements. These timing differences arise from the inclusion of income and expenses in tax assessments in periods different from those in which they are recognised in the Financial Statements.

Deferred tax is recognised on all timing differences at the reporting date. Unrelieved tax losses and other deferred tax assets are only recognised when it is probable that they will be recovered against the reversal of deferred tax liabilities or other future taxable profits.

Deferred tax is measured using tax rates and laws that have been enacted or substantively enacted at the balance sheet date and that are expected to apply to the reversal of the timing difference.

1.4.25 Dividends

Dividends on ordinary shares are recognised as a liability and deducted from equity when they are approved by the shareholders. Interim dividends are deducted from equity when they are paid.

Notes to the Financial Statements (continued)

2. Segmental Analysis

An analysis of the underwriting result before investment return is set out below:

2018	Gross premium written $000	Gross premium earned $000	Gross claims incurred $000	Gross operating expenses $000	Re-insurance balance $000	Total $000
Direct insurance:						
Marine aviation & transport	172,216	153,100	(112,253)	(45,914)	4,995	**(72)**
Primary Direct & Fac Property	115,810	124,045	(90,327)	(44,300)	(703)	**(11,285)**
Primary Direct Commercial Financial	219,881	154,431	(102,841)	(42,250)	(11,465)	**(2,125)**
Primary Direct Commercial Liability	684,088	605,752	(356,949)	(221,491)	(43,830)	**(16,518)**
Personal lines	124,764	105,841	(35,588)	(34,903)	(24,639)	**10,711**
	1,316,759	1,143,169	(697,958)	(388,858)	(75,642)	**(19,289)**
Reinsurance	284,597	120,277	(65,726)	(67,860)	(15,323)	**(28,632)**
Total	**1,601,356**	**1,263,446**	**(763,684)**	**(456,718)**	**(90,965)**	**(47,921)**

2017	Gross premium written $000	Gross premium earned $000	Gross claims incurred $000	Gross operating expenses $000	Re-insurance balance $000	Total $000
Direct insurance:						
Marine aviation & transport	129,402	132,000	(202,278)	(36,240)	71,007	**(35,511)**
Primary Direct & Fac Property	120,487	122,178	(165,801)	(39,189)	25,160	**(57,652)**
Primary Direct Commercial Financial	187,943	124,736	(38,637)	(40,925)	(17,345)	**27,829**
Primary Direct Commercial Liability	536,577	519,319	(365,694)	(162,021)	(43,891)	**(52,287)**
Personal lines	177,639	149,961	(93,393)	(59,415)	3,393	**546**
	1,152,048	1,048,194	(865,803)	(337,790)	38,324	**(117,075)**
Reinsurance	98,614	48,004	(29,420)	(45,895)	6,258	**(21,053)**
Total	**1,250,662**	**1,096,198**	**(895,223)**	**(383,685)**	**44,582**	**(138,128)**

Commissions paid in respect of direct insurance amounted to $327,187k (2017: $205,981k).

Notes to the Financial Statements (continued)

2. Segmental Analysis (continued)

The geographical analysis of gross premiums written by country of underwriting is as follows:

	2018 $000	2017 $000
UK	1,198,462	920,491
Other EU Countries	357,667	233,434
Worldwide	45,228	96,737
Total	**1,601,356**	**1,250,662**

3. Investment Return

	Technical account General business		Non-Technical account		Total	
	2018 $000	2017 $000	2018 $000	2017 $000	2018 $000	2017 $000
Income from other financial investments	53,569	25,127	1,558	2,360	55,127	27,487
Net gain/(loss) on realisation of investments						
– Fair value through profit or loss designated upon initial recognition	2,559	784	74	74	2,633	858
– Available for sale	(4,301)	3,984	(125)	374	(4,426)	4,358
Total Investment Income	51,827	29,895	1,507	2,808	53,334	32,703
Net unrealised losses on investments						
– Fair value through profit or loss designated upon initial recognition	(412)	873	(12)	82	(424)	955
Investment expenses and charges	(3,117)	(2,958)	(91)	(278)	(3,208)	(3,236)
Total investment return	**48,298**	**27,810**	**1,404**	**2,612**	**49,702**	**30,422**

There was no impairment during the year of in respect of Financial Investments (2017: $1.6m).

Notes to the Financial Statements (continued)

4. Net operating expenses

	2018 $000	2017 $000
Acquisition costs	412,518	303,863
Change in gross deferred acquisition costs (see Note 13)	(78,159)	(61,890)
Depreciation expense (see Note 12)	1,144	1,162
Administrative expenses	121,215	140,550
Gross operating expenses	**456,718**	**383,685**
Reinsurers' commission receivable	(154,014)	(152,700)
Change in Reinsurers' share in deferred acquisition costs	35,534	15,741
Net operating expenses	**338,238**	**246,726**

Included within Administrative expenses there is bad debt of $2.2m (2017: $1.3m).

5. Staff Costs and Director's Remuneration

5.1. Staff costs

All UK staff are employed by Liberty Specialty Markets Limited (LSML), an affiliated company. All European are employed by Liberty Specialty Markets Europe S.A.R.L. (LSME). The following amounts were incurred by the Company for the staff seconded from LSML:

	2018 $000	2017 $000
Wages and salaries	53,086	54,915
Social security costs	6,921	2,809
Other pension costs (see Note 26)	8,254	12,253
	68,261	69,977

The average number of employees seconded to or employed by the Company during the year was as follows:

	2018	2017
Underwriting	91	185
Claims	30	37
Administration	201	227
	322	449

Notes to the Financial Statements (continued)

5. Staff Costs and Director's Remuneration (continued)

5.2. Director's Remuneration

Directors' emoluments

	2018 $000	2017 $000
Emoluments	3,504	2,963
Highest paid Director's Remuneration	1,430	896

During the year, none of the directors were members of the defined benefit contribution scheme (2017: three). The directors were employed by fellow Group companies.

6. Auditor's Remuneration

	2018 $000	2017 $000
Audit of the financial statements	1,058	910
Other fees:		
Other services pursuant to legislation	110	291
Audit-related assurance services	-	13
Audit of the group pension scheme	11	10
	1,179	**1,224**

Auditor's remuneration is included is included as part of administrative expenses in Note 4.

Notes to the Financial Statements (continued)

7. Taxation

7.1 Tax on loss on ordinary activities

	2018 $000	2017 $000
Current taxation:		
UK corporation tax at 19.25% (2017: 19.25%) - current year	2,917	(10,027)
UK corporation tax - adjustments in respect of prior years	786	1,815
UK corporation tax	3,703	(8,212)
Foreign taxation - current year	3,108	5,004
Foreign tax - adjustments in respect of prior years	1,184	1,302
Foreign tax	4,292	6,306
Total current taxation	**7,995**	**(1,906)**
Deferred taxation:		
Origination and reversal of timing differences	(2,117)	(10,679)
Adjustment in respect of prior periods	5,980	693
Total deferred tax	**3,863**	**(9,984)**
Tax on profit on ordinary activities	**11,857**	**(11,890)**
Tax included in the statement of other comprehensive income		
Tax expense / (income) is made up as follows:		
Actuarial loss on pension scheme	(161)	1,240
Current tax on unrealised gains and losses on available for sale securities	(718)	1,408
Deferred tax on unrealised gains and losses on available for sale securities	(8,639)	480
Current tax on Pension Payment	-	(302)
Tax expense	**(9,518)**	**2,826**

Notes to the Financial Statements (continued)

7. Taxation (continued)

7.2 Factors affecting tax charges for the period

The tax assessed for the year is higher (2017: lower) than the standard rate of corporation tax in the UK. The differences are reconciled below:

	2018 $000	2017 $000
Profit on ordinary activities before tax	**(6,982)**	**(125,572)**
Profit on ordinary activities multiplied by standard rate of UK corporation tax in the UK of 19.25% (2016: 20%)	(1,326)	(24,172)
Expenses not deductible for tax purposes	2,277	1,428
Tax under/(over) provided in previous years	1,971	3,117
Difference between UK and foreign tax rates on non-UK branches	1,426	7,571
Deferred tax at rates other than the standard rate for the year	(165)	1,396
Gain on transfer of assets	-	641
Deferred tax under provided in prior years	5,981	693
Deferred tax not recognised	1,695	473
Non taxable income	(2)	(3,037)
Tax (income)/expense for the year	**11,857**	**(11,890)**

Deferred tax assets and liabilities are recognised at the substantively enacted rate, for the respective jurisdictions, at the balance sheet date. A reduction in the UK corporation rate from 20% to 19% took effect from 1 April 2017. In addition, a reduction to the Italian corporate tax rate from 27.5% to 24% took effect from 1 January 2017.

There will be a further reduction in the UK tax rate to 17% from 1 April 2020, reductions to the French corporate tax rate to 28.92% from 1 January 2020, 27.37% from 1 January 2021 and 25.83% from 1 January 2022, reductions to the corporate tax rate in the Netherlands to 24% from 1 January 2019, 22.5% from 1 January 2020 and 21% from 1 January 2021, and reductions in the corporate tax rate in Switzerland to 19.7% in 2021 and 18.19% in 2023. There has been no material impact to the deferred tax balances as a result of these changes.

Notes to the Financial Statements (continued)

7. Taxation (continued)

7.3 Deferred tax

The deferred tax included in the statement of financial position is as follows:

	2018 $000	2017 $000
Unrealised gains on available for sale securities	(1,759)	(10,398)
Accelerated capital allowances	730	283
Pension costs	(3,153)	(2,835)
Tax losses	2,649	8,109
Branch deferred tax liabilities	(220)	(544)
Deferred costs	144	(1,255)
Deferred tax liability (note 19)	(1,609)	(6,640)

An analysis of the movement in deferred tax is as follows:

	2018 $000	2017 $000
At 1 January	(6,640)	(14,999)
Deferred tax (expense) / income in profit and loss account	(3,864)	9,984
Deferred tax (expense) / income in other comprehensive income	8,800	(1,720)
Exchange adjustment	95	95
At 31 December	(1,609)	(6,640)

The balance of deferred tax losses relates to UK taxable losses carried forward at 31 December 2018 of $15,584k (2017: $46,947k). The recoverability of these losses has been assessed on future UK taxable profits expected to reverse from deferred tax liabilities, recognised in the balance sheet.

Gross unrecognised tax losses of $6,617k (2017: $13,918k) and other gross deferred tax assets of $0k (2017: $4,587k) are available to reduce the future taxable profits of the company. Deferred tax assets have not been recognised for branches of the company where it is uncertain that there will be future taxable profits.

The amount of the net reversal of deferred tax assets and deferred tax liabilities expected to occur during the year beginning after the reporting period are as follows:

	2019 $000
Unrealised gains on Available for sale Securities	(1,039)
Reversal of Claims Equalisation Reserve over 6 years	(1,004)
Total expected movement	(2,043)

All other positions are too uncertain to predict when they will reverse.

Notes to the Financial Statements (continued)

8. Investment in subsidiary undertakings

The investment in subsidiary undertaking relates solely to LMIE Spain S.L., a holding company incorporated in Spain, in which the Company holds a 100% investment in ordinary shares.

9. Financial investments

2018	Carrying Value $000	Purchase Price $000	Listed $000
Shares and other variable yield securities and units in unit trust at fair value through profit and loss	13,943	13,317	-
Debt securities and other fixed income securities at fair value through OCI	2,437,327	2,473,609	409,313
Deposits with credit institutions at fair value	143,524	143,524	-
Total	**2,594,794**	**2,630,450**	**409,313**

2017	Carrying Value $000	Purchase Price $000	Listed $000
Shares and other variable yield securities and units in unit trust at fair value through profit and loss	16,828	15,777	-
Debt securities and other fixed income securities at fair value through OCI	2,189,401	2,198,437	459,942
Deposits with credit institutions at fair value	163,077	163,077	-
Total	**2,369,306**	**2,377,291**	**459,942**

All shares and other variable yield securities are designated at fair value through profit and loss.

Debt securities and other fixed income securities and deposits with credit institutions are held as available for sale. Changes in fair value are recognised through other comprehensive income.

The following table shows financial investments recorded at fair value analysed between the three levels in the fair value hierarchy.

Notes to the Financial Statements (continued)

9. Financial investments (continued)

2018	Level 1 $000	Level 2 $000	Level 3 $000	Total $000
Shares and other variable yield securities and units in unit trusts	-	-	13,943	13,943
Debt securities and other fixed income securities	154,143	2,281,511	1,673	2,437,327
Deposits with credit institutions	-	143,524	-	143,524
Total	**154,143**	**2,425,035**	**15,616**	**2,594,794**

2017	Level 1 $000	Level 2 $000	Level 3 $000	Total $000
Shares and other variable yield securities and units in unit trusts	-	-	16,828	16,828
Debt securities and other fixed income securities	122,388	2,035,375	31,638	2,189,401
Deposits with credit institutions	-	163,077	-	163,077
Total	**122,388**	**2,198,452**	**48,466**	**2,369,306**

There have been no transfers between the various levels during the year.

Included within the Level 1 category are unadjusted quoted prices in active markets for identical assets that the Company has the ability to access at the measurement date. A quoted price in an active market provides the most reliable evidence of fair value and is used to measure fair value whenever available, except as follows:

If the Company holds a large number of similar assets that are required to be measured at fair value, a quoted price in an active market might be available but not readily accessible for each of those assets individually. In that case, fair value may be measured using an alternative pricing method that does not rely exclusively on quoted prices (for example, matrix pricing) as a practical expedient. However, the use of an alternative pricing method renders the fair value measurement a lower level in the fair value hierarchy.

In some situations, a quoted price in an active market might not represent fair value at the measurement date. That might be the case if, for example, significant events (principal-to-principal transactions, brokered trades, or announcements) occur after the close of a market but before the measurement date.

If the quoted price is adjusted for new information, the adjustment renders the fair value measurement a lower level in the fair value hierarchy. Level 2 inputs are inputs other than quoted prices that are either directly or indirectly observable in the market. If the asset has a specified contractual term, a Level 2 input must be observable for substantially the full term of the asset.

Adjustments to Level 2 inputs may vary depending on factors specific to the asset type. Those factors include the condition and/or location of the asset, the extent to which the inputs relate to items that are comparable to the asset, and the volume and level of activity in the markets within which the inputs are observed. An adjustment that is significant to the fair value measurement in its entirety might render the measurement a Level 3 measurement, depending on the level in the fair value hierarchy within which the inputs used to determine the adjustment fall.

Notes to the Financial Statements (continued)

9. Financial investments (continued)

Level 3 inputs are unobservable inputs for the asset. Unobservable inputs are used to measure fair value to the extent that observable inputs are not available, thereby allowing for situations in which there is little, if any, market activity for the asset at the measurement date. Unobservable inputs reflect the Company's own assumptions about the assumptions that market participants would use in pricing the asset or liability including assumptions about risk. Unobservable inputs are developed based on the best information available in the circumstances.

All manually priced broker quotes are non-binding. The Portfolio Manager makes an assessment of the reasonableness of the broker quote received. Based on the Portfolio Manager's assessment, additional quotes may be obtained to support the fair value of an investment, in which case, the average of those quotes is used as the fair value of the investment. The Portfolio Manager provides support for the manual price and Investments determines the appropriate level (level 2 or level 3) for the security. Manually priced broker quotes obtained on an individual case basis that cannot be substantiated to represent an executable/ exit price are classified as level 3. If the security was actively trading (with significant volume) within a thirty-day period from the last day it was manually priced, evidence of the active trade with a broker quote is appropriate documentation to classify the security a level 2. If the security was not actively trading, they are classified as level 3. When the average of multiple broker quotes is used, the level (2 or 3) is determined based on whether or not those quotes can be substantiated.

The Company asset portfolio includes Private Equity investments. These have all been classified as Level 3 based on the criteria above. The Group Portfolio Manager receives partnership statements / Financial Statements for each investment from which the residual values are recorded, and then potentially adjusted when combined with adjusted ending value reports. The Group Portfolio Manager then recommends a valuation for each position, based on these statements and their own assessment/judgement.

10. Debtors arising out of reinsurance operations

	2018 $000	2017 $000
Underwriting debtors	540,970	234,871
Amounts due from group undertakings	45,729	25,572
	586,699	**260,443**

11. Other debtors

	2018 $000	2017 $000
UK and overseas net tax debtor	4,708	-
Amounts due from group undertakings	45,847	13,643
Other debtors	1,879	6,360
	52,434	**20,003**

The net tax debtor of $4,708k also includes creditor balances in respect of other overseas branches which have not been separately disclosed on the basis that the balances are not sufficiently material.

Notes to the Financial Statements (continued)

12. Tangible assets

	Leasehold improvements	Fixtures, fittings & equipment	Total
	$000	$000	$000
Cost:			
At 1 January 2018	9,200	4,640	13,840
Additions during the year	0	0	0
Disposals during the year	(2,993)	(367)	(3,360)
At 31 December 2018	**6,207**	**4,273**	**10,480**
Accumulated depreciation:			
At 1 January 2018	1,615	2,400	4,015
Charge for the year	378	766	1,144
Disposals during the year	(531)	(367)	(898)
At 31 December 2018	**1,462**	**2,799**	**4,261**
Carrying value at 31 December 2018	4,745	1,474	6,219
Carrying value at 31 December 2017	7,585	2,240	9,825

13. Deferred acquisition costs

	2018	2017
	$000	$000
At 1 January	251,651	182,623
Change in deferred acquisition costs	78,159	61,890
Foreign exchange	(782)	7,138
At 31 December	**329,028**	**251,651**

14. Share capital

	2018	2017
	$000	$000
Issued and fully paid:		
290,090,800 (2017: 290,090,781) ordinary shares of $1 each	290,091	290,091
178,320 (2017: 148,320) ordinary shares of €0.81 each	178	148
At 31 December	290,269	290,239

The Company issued 30,000 ordinary shares of €0.81 each at par and 19 ordinary shares of $1 each at a premium. The premium arising on issue of shares is recognised in the Share premium account.

Notes to the Financial Statements (continued)

15. Reserves

Share premium account

This statutory reserve records the amount of the nominal value received for shares sold, less transaction costs.

The movement on the share premium reserve in the year was $360m (2017: nil).

Available for sale reserve

This reserve records the unrealised fair value gains/(losses), net of deferred taxation, on available for sale investments.

16. Provisions for unearned premium

2018	Gross $000	Reinsurers' Share $000	Net $000
At 1 January 2018	947,557	(285,434)	662,123
Premiums written in the year	1,601,356	(530,283)	1,071,073
Premiums earned in the year	(1,263,446)	436,578	(826,868)
Foreign exchange	(29,218)	5,208	(24,010)
At 31 December 2018	**1,256,249**	**(373,931)**	**882,318**

2017	Gross $000	Reinsurers' Share $000	Net $000
At 1 January 2017	774,354	(252,883)	521,471
Premiums written in the year	1,250,662	(490,942)	759,720
Premiums earned in the year	(1,096,198)	453,696	(642,502)
Foreign exchange	18,739	4,695	23,434
At 31 December 2017	**947,557**	**(285,434)**	**662,123**

Notes to the Financial Statements (continued)

17. Claims outstanding

2018	Gross $000	Reinsurers' share $000	Net $000
At 1 January 2018	2,469,348	(912,708)	1,556,640
Claims incurred during the year	763,684	(227,134)	536,550
Claims paid during the year	(606,808)	226,087	(380,721)
Foreign exchange	(79,297)	23,538	(55,759)
At 31 December 2018	**2,546,927**	**(890,217)**	**1,656,710**

2017	Gross $000	Reinsurers' share $000	Net $000
At 1 January 2017	2,008,680	(716,984)	1,291,696
Claims incurred during the year	895,223	(361,319)	533,904
Claims paid during the year	(509,236)	166,575	(342,661)
Foreign exchange	74,681	(980)	73,701
At 31 December 2017	**2,469,348**	**(912,708)**	**1,556,640**

18. Creditors arising out of reinsurance operations

	2018 $000	2017 $000
Underwriting creditors	128,658	122,711
Amounts due to group undertakings	153,148	68,374
	281,806	**191,085**

19. Other creditors including taxation and social security

	2018 $000	2017 $000
Premium taxes payable	41,165	30,314
Deferred Tax Liability (Note 7)	1,609	6,640
Amounts owed to group undertakings	11,727	16,114
Other creditors	10,296	18,411
	64,797	**71,479**

Notes to the Financial Statements (continued)

20. Other provisions

The table below describes the movement in the onerous lease provision during the year:

	2018 $000	2017 $000
At 1 January	946	3,250
Onerous lease charge inc. dilapidations	(821)	(2,304)
At 31 December	**125**	**946**

The onerous lease provision represents unoccupied properties. This provision has been reduced substantially in 2018 as a result of the Company successfully being able to sub-let some of the properties.

21. Pension schemes

The Company participated in a funded group defined benefit scheme in the UK, together with fellow subsidiaries of Liberty Mutual Holding Company Inc. Former employees who are now employed by a Group company previously participated in the Scheme. The Company continues to be a joint sponsor of the scheme which closed to future accrual on 1 July 2012 with active members of the scheme becoming deferred pensioners in the Scheme from 2 July 2012.

The Scheme is administered by a separate board of Trustees which is legally separate from the Company. The Trustees are composed of representatives of both the employer and employees. The Trustees are required by law to act in the interest of all relevant beneficiaries and are responsible for the investment policy with regard to the assets plus the day to day administration of the benefits.

Under the Scheme, employees are entitled to annual pensions on retirement at age 65 of one-sixtieth of final pensionable salary for each year of service. Pensionable salary is defined as basic salary less the Basic State Pension. Benefits are also payable on death and following other events such as withdrawing from active service.

UK legislation requires that pension schemes are funded prudently. The last funding valuation of the Scheme was carried out by a qualified actuary as at 1 July 2016 and showed a deficit of £2m. The Company and fellow subsidiaries have paid deficit contributions of £2m in April 2017 which were intended to make good this shortfall. The next funding valuation is due no later than 1 July 2019, with the results to be finalised no later than 1 October 2020.

No allowance has been made for administration expenses (including PPF levies). These are met directly by the Company.

Reporting at 31 December 2018

The results of the latest funding valuation at 1 July 2016 have been adjusted to the balance sheet date, taking into account experience over the period since 1 July 2016, changes in market conditions, and differences in financial and demographic assumptions. The present value of the defined benefit obligation is measured using the Projected Unit Credit Method.

Assumptions

The principal assumptions used to calculate the liabilities under are set out below:

Notes to the Financial Statements (continued)

21. Pension schemes (continued)

Main financial assumptions

At 31st December	2018 % p.a.	2017 % p.a.
RPI inflation	3.3	3.2
CPI inflation	2.2	2.1
Rate of general long-term increase in salaries	N/A	N/A
Pension increase (fixed 3%)	3.0	3.0
Pension increase (fixed 5%)	5.0	5.0
Pension increase (LPI5)	3.2	3.1
Discount rate for scheme liabilities	3.2	2.5

The financial adjustments reflect the nature and term of the Scheme's liabilities.

For a pensioner aged 65 at the year end, the assumptions are that they will live on average for a further 23.7 years if they are male and for a further 24.8 years if they are female.

Asset allocation

The assets in the scheme were:

Value at 31 December	2018 $000	2017 $000
UK equities	17,155	22,953
Alternatives	7,400	6,097
Liability Hedging	(4,473)	(2,890)
Corporate bonds	2,957	5,701
Fixed Interest Gilts	4,633	3,307
Index-Linked Gilts	5,775	6,430
Property	2,034	2,141
Cash/net current assets	4,081	2,433
Total	39,562	46,172

Reconciliation of funded status to balance sheet

Value at 31 December	2018 $000	2017 $000
Fair value of scheme assets	39,562	46,172
Present value of funded defined benefit obligations	(30,619)	(38,053)
Asset recognised in the balance sheet	**8,943**	**8,119**

The Company will derive economic benefits from the pension surplus in the event the pension is scheme is wound up. Consequently, the pension surplus has been recognised as an asset.

Notes to the Financial Statements (continued)

21. Pension schemes (continued)

Breakdown of amounts recognised in profit and loss

	2018 $000	2017 $000
Financing cost		
- Interest on net defined benefit (asset)	(201)	(149)
Pension expense recognised in profit and loss	(201)	(149)

Breakdown of amounts recognised in other comprehensive income

	2018 $000	2017 $000
Return on plan assets below/(in excess of) that recognised in net interest	3,931	(2,169)
Actuarial (gains)/losses due to changes in actuarial assumptions	(4,040)	1,377
Actuarial (gains)/losses due to changes in demographic assumptions	(1,096)	45
Actuarial gains due to liability experience	94	(926)
Total amount recognised in other comprehensive income	**(1,111)**	**(1,673)**

Changes to the present value of the defined benefit obligation

	2018 $000	2017 $000
Opening defined benefit obligation (DBO)	38,053	36,345
Interest expense on DBO	885	1,026
Actuarial (gain)/losses on liabilities	(4,845)	513
Net benefits paid out	(1,770)	(2,987)
Re-translation of opening balance	(1,704)	3,156
Closing defined benefit obligation	**30,619**	**38,053**

Changes to the fair value of Scheme assets

	2018 $000	2017 $000
Opening fair value of Scheme assets	46,172	40,678
Interest income on Scheme assets	1,079	1,181
Remeasurement (losses)/gains on Scheme assets	(3,776)	2,243
Contributions made by the employer	-	1,550
Net benefits paid out	(1,770)	(2,987)
Re-translation of opening balance	(2,143)	3,507
Closing fair value of assets	**39,562**	**46,172**

Notes to the Financial Statements (continued)

21. Pension schemes (continued)

Actual return on Scheme assets

	2018 $000	2017 $000
Interest income on Scheme assets	1,079	1,181
Remeasurement gains/ losses on scheme assets	(3,776)	2,243
Surplus/ (Deficit) in the scheme	**(2,697)**	**3,424**

22. Risk Management

22.1. Governance framework

The objective of LSM's Risk Management and Internal Control Framework (RMF), under which the Company operates, is to enable it to engage with risks in a controlled fashion that is consistent with the Board's appetite and its available capital capacity while retaining the ability to implement its long-term business plans and meet its obligations to policyholders. It sets out the Company's approach to, how it defines risk and cascades risk appetites and the processes for ensuring the appropriate and timely identification, reporting, monitoring and management of risk and capital. The Company's senior management recognises the importance of maintaining an efficient and effective risk management system.

The RMF establishes the governance of the risk management activities undertaken within the Company, including the setting of roles and responsibilities, outlining the key risk management concepts and providing a clear structure linking the individual risk policies, processes and procedures. The RMF is owned by the Board.

The key concepts include the linkage of business strategy to risk management strategy, the identification of emerging risks, the risk universe, the management of risks through the setting of risk appetites and the creation, maintenance, recording and testing of internal controls.

The Company has an established Risk Management function (which includes the Risk Management department under the Chief Risk Officer (CRO), and processes within the Capital Management and Actuarial departments), with oversight from the Risk Management Committee (a sub-committee of the Board) chaired by an independent non-executive director; the terms of reference incorporate the CRO's ability to convene a meeting independently of the executive management. In addition, the terms of reference for relevant management Committees incorporate risk management responsibilities as delegated by the Board.

The Company recognises that all staff have a role to play in managing the risks faced by the Company. This reflects the three lines of defence model adopted by the Company, consistent with market best practice, which emphasises the different roles in managing risk played by business units, advisory functions such as Risk Management, and independent assurance providers such as Internal Audit. The roles and responsibilities are documented in the risk policies, which are owned by the Board and adhere to the Company's documentation standards. Each risk policy is owned by a member of the Executive Management Committee. The policies include the activities of identification, quantification, management and reporting on risks, including reporting on the performance of controls and the Company's actual risk position against the Board risk appetite. The Company undertakes extensive work to validate the quantification of its risk profile using the Standard Formula and Internal Model including the use of sensitivity testing, and stress and scenario testing. The Company's risk profile is reported to the Board via the ORSA and the Chief Risk Officer's report.

Notes to the Financial Statements (continued)

22. Risk Management (continued)

22.2. Capital management objectives, policies and approach

The Company structures its capital to at all time to have sufficient own funds to cover the Solvency Capital Requirement (SCR) and Minimum Capital Requirement (MCR) with an appropriate prudence margin.

Company policyholders benefit from a parental guarantee covering the Company's insurance obligations to an unlimited extent, drawn upon Liberty Mutual Insurance Company (LMIC). The guarantee was originally granted by the Board of LMIC and ratified by the Massachusetts' Department of Insurance in 2002 and last updated and re-issued on 13 April 2006.

The Company manages its capital through the management of its assets to ensure that cash is available to pay claims (measured at the 1 in 200-year loss) as they fall due. Asset-liability management is reviewed

in conjunction with investment and liquidity management in order to optimise the overall performance of assets. The Company will set regulatory capital based the legal entity business plan, which in turn reflects on the overall LSM plan agreed. The capital requirement is supported by two components: ordinary share capital and retained earnings, both of which qualify as unrestricted Tier 1 capital under Solvency II. The Company's surplus funds are primarily held within the primary investment portfolio, which is managed under guidelines which are designed to ensure they are liquid within appropriate timeframes. Surplus funds are held in US dollars, the Company's functional and presentational currency.

As part of its risk appetite LMIE defines the amount of capital required to meet its internal risk appetite and regulatory capital requirement. LMIE's capital risk appetite is set by the Company's Board as part of the ORSA process. The Board will have the potential to pay a dividend only if the solvency ratio is within its stated risk appetite.

Refer to Strategic Report for further details of the regulatory capital requirement.

22.3. Insurance risk

Insurance risk incorporates premium risk and reserve risk. Premium risk is the variation of underwriting results from plan for reasons other than operational or insurance counterparty risk. This is influenced by the frequency and severity of claims events.

Reserve risk is the variation in policyholder reserves for prior accident years required for reasons other than operational or insurance counterparty risk. This is influenced by uncertainty in the notification of claims and value of claims paid.

Premium risk is mitigated through the use of a diversified business plan operating within Board risk appetites and supported through the Company's control environment, including underwriting controls. Reinsurance is utilised to mitigate against exposure to individual and correlated events.

Reinsurance is purchased on both a proportional and non-proportional basis. The majority of the proportional reinsurance is purchased on a quota share basis; this is designed to reduce the overall exposure to certain classes of business. Non-proportional reinsurance is purchased on an excess of loss and stop loss basis. The excess of loss reinsurance is purchased on both a per-risk and catastrophe basis covering natural and non-naturally occurring perils. The stop loss is purchased on a net underwriting loss basis to protect the Company's overall solvency. The non-proportional reinsurance is purchased to mitigate against shock losses to individual underwriting product lines and to protect the Company's balance sheet from catastrophe losses on a multi-line basis.

Amounts recoverable from reinsurers are estimated in a manner consistent with the outstanding claims provision and are in accordance with the reinsurance contracts. The use of reinsurance exposes the Company to a counterparty credit exposure; this is reported under credit risk.

Notes to the Financial Statements (continued)

22. Risk Management (continued)

22.3. Insurance risk (continued)

The Company's business plan is developed in accordance with the Company's Board risk appetites to reduce the variability of the underwriting profit through the creation of a diversified portfolio of insurance contracts. The Company's portfolio of general insurance contracts is spread across multiple product lines, industry sectors and geographic regions. The Company writes both insurance and reinsurance contracts; both of which predominantly cover twelve months duration. Contracts are written by specialised underwriting teams in accordance to the business plan and the underwriting controls.

Furthermore, strict claim review policies to assess all new and ongoing claims, regular detailed review of claims handling procedures and frequent investigation of possible fraudulent claims are all policies and procedures put in place to reduce the Company's risk exposure. The Company further enforces a policy of actively managing and promptly pursuing claims, in order to reduce its exposure to unpredictable future developments that can negatively impact the business.

The Company has exposure to the Ogden Discount Rate primarily through the UK Casualty lines. The change announced by the Lord Chancellor in February 2017 that the UK personal injury discount rate would reduce from plus 2.5% to minus 0.75% increased the estimate of the technical provisions. There is ongoing uncertainty, with up and downside risk, as to what legislative changes the UK Government may make to the methodology and approach used to inform the rate.

Exposure to concentrations arising from the insurance contracts is a material risk to the Company. The Board risk appetites include specific exposure management limits; these are cascaded down to individual underwriting portfolios. The concentrations are tiered in accordance to the Company's exposure management policies; with the resulting tier determining the appropriate methodology for quantification. The Company supports its internal quantification of exposure concentrations by utilising external, commercially available exposure management models.

Exposure management models are validated to ensure they are parameterised appropriately for the Company's portfolio, however, there remains a risk that the assumptions and techniques used in these models are unreliable or that claims arising from an unmodelled event are greater than those arising from a modelled event.

As a further guide to the level of concentration of exposure the Company writes, the following table shows the Company's exposure to its three largest natural catastrophe perils:

	Industry Loss $000	Company loss Gross $000	Company loss Final Net $000
European Wind	39,196,000	418,577	148,560
Turkey Earthquake	N/A	153,880	57,612
UK Flood	70,014,000	128,802	49,670

Reserve risk is mitigated through the use of detailed analysis performed by the Reserving Committee, including regular assessment of the results of actuarial studies, claims analysis, underwriting reviews and benchmarking exercises. In addition, business plans are developed to ensure that the long term reserve profile of the Company remains stable.

Notes to the Financial Statements (continued)

22. Risk Management (continued)

22.3. Insurance risk (continued)

The table below sets out the concentration of outstanding claim liabilities by type of contract:

	31 December 2018			31 December 2017		
	Gross liabilities	Re-insurance of liabilities	Net liabilities	Gross liabilities	Re-insurance of liabilities	Net liabilities
	$000	$000	$000	$000	$000	$000
Commercial	(1,938,266)	615,269	(1,322,997)	(1,936,791)	674,076	(1,262,715)
Specialty	(517,465)	246,831	(270,634)	(490,192)	223,584	(266,608)
Reinsurance	(91,196)	28,117	(63,079)	(42,365)	15,048	(27,317)
Total	(2,546,927)	890,217	(1,656,710)	(2,469,348)	912,708	(1,556,640)

The geographical concentration of the outstanding claim liabilities is noted below. The disclosure is based on the countries where business is written.

	31 December 2018			31 December 2017		
	Gross liabilities	Re-insurance of liabilities	Net liabilities	Gross liabilities	Re-insurance of liabilities	Net liabilities
	$000	$000	$000	$000	$000	$000
UK	(1,578,096)	428,821	(1,149,275)	(1,621,888)	485,783	(1,136,105)
EEA	(704,578)	332,299	(372,279)	(566,200)	272,293	(293,907)
International	(264,253)	129,097	(135,156)	(281,260)	154,632	(126,628)
Total	(2,546,927)	890,217	(1,656,710)	(2,469,348)	912,708	(1,556,640)

Key Assumptions

The principal assumption underlying the liability estimates is that the future claims development will follow a similar pattern to past claims development experience. This includes assumptions in respect of paid and incurred claims, claim handling costs and claim inflation factors for each underwriting year. Additional qualitative judgements are used to assess the extent to which past trends may not apply in the future, for example: once–off occurrence; changes in market factors such as public attitude to claiming: economic conditions: as well as internal factors such as portfolio mix, delays in settlement, policy conditions, and claims handling procedures. Judgement is further used to assess the extent to which external factors such as judicial decisions and government legislation affect the estimates.

Sensitivities

There is a wide range of possible outcomes in assessing the technical provisions due to the uncertainty associated in estimating ultimate claims and premiums for the business written.

For all actuarial projections the final outcome will depend on the actual development of claims which in turn relies upon the appropriateness of the historic data to predict the likely development by class.

Notes to the Financial Statements (continued)

22. Risk Management (continued)

22.3. Insurance risk (continued)

Unforeseen changes may affect the suitability of that data and would be expected to have an impact on the accuracy of the results and increased uncertainty in the projections. Such issues would include unexpected claims inflation, shocks to the global economy, changes in legislation and the emergence of new types of claim.

The results and accuracy of some underwriting classes can be sensitive to the performance of certain key contracts, either through large exposures or through a large volume of business being written under the contract, relative to the size of the account. Additionally, ultimate claims are highly dependent to exposure to and the future incidence to economic events given the nature of the underlying risks through Financial Institution exposures.

A large proportion of the Technical Provisions are in long-tail casualty classes, which increases the uncertainty relative to other classes of business. The Actuarial best estimates make no provision for potential uncertainty of future claims arising from new latent causes or classes of claim not as yet materially recognised in the historical experience.

An increasingly significant proportion of business is also written through coverholders. There is increased uncertainty in this business as a result of the challenges in maintaining underwriter discipline in a softening market.

Significant assumptions for the Company did not materially change from the previous period.

The following table illustrates the impact a 5% increase or decrease in net technical provisions would have on the profit or loss before tax:

	2018		2017	
	5% Increase $000	5% Decrease $000	5% Increase $000	5% Decrease $000
Total	(83,070)	83,070	(77,832)	77,832

Claims development table

The following tables show the estimates of cumulative incurred claims, including both claims notified and IBNR for each underwriting year at each reporting date, together with cumulative payments to date.

Gross insurance contract outstanding claims provision as at 31 December 2018:

Estimate of cumulative claims	2010 and prior $000	2011 $000	2012 $000	2013 $000	2014 $000	2015 $000	2016 $000	2017 $000	2018 $000	Total $000
At end of underwriting year	1,765,884	245,877	258,824	211,983	242,489	448,938	310,989	479,326	365,740	
One year later	1,896,141	417,021	520,707	444,307	650,040	777,068	690,411	832,240	-	
Two years later	1,954,625	475,994	524,673	484,646	621,015	902,657	695,506	-	-	
Three years later	2,068,906	475,731	510,748	475,908	680,869	907,574	-	-	-	
Four years later	2,032,063	438,751	480,446	481,868	673,834	-	-	-	-	
Five years later	1,753,464	426,959	499,012	451,235	-	-	-	-	-	
Six years later	1,700,518	424,429	493,378	-	-	-	-	-	-	
Seven years later	1,683,250	417,314	-	-	-	-	-	-	-	
Eight years later	1,689,387	-	-	-	-	-	-	-	-	
Cumulative payments	1,432,757	350,769	384,521	335,428	411,195	484,803	304,987	234,610	40,211	
Estimated balance to pay	256,630	66,545	108,857	115,807	262,639	422,771	390,519	597,630	325,529	2,546,927

Notes to the Financial Statements (continued)

22. Risk Management (continued)

22.3. Insurance risk (continued)

Net insurance contract outstanding claims provision as at 31 December 2018:

Estimate of cumulative claims	2010 and prior $000	2011 $000	2012 $000	2013 $000	2014 $000	2015 $000	2016 $000	2017 $000	2018 $000	Total $000
At end of underwriting year	951,126	101,698	135,007	140,463	214,349	319,763	215,163	255,713	287,360	
One year later	1,055,603	200,337	249,351	295,630	356,651	519,161	440,237	457,011	-	
Two years later	1,078,337	217,755	258,574	318,648	345,532	606,165	461,495	-	-	
Three years later	1,086,337	214,099	301,289	312,677	392,297	576,647	-	-	-	
Four years later	1,064,462	230,847	281,093	315,442	386,253	-	-	-	-	
Five years later	928,329	222,470	294,945	301,316	-	-	-	-	-	
Six years later	913,913	225,416	292,838	-	-	-	-	-	-	
Seven years later	912,204	224,817	-	-	-	-	-	-	-	
Eight years later	942,900	-	-	-	-	-	-	-	-	
Cumulative payments	748,167	183,919	217,367	228,759	220,371	317,508	197,050	122,074	29,323	
Estimated balance to pay	194,733	40,898	75,471	72,557	165,882	259,139	264,445	334,937	248,648	1,656,710

As claims develop, and the ultimate cost of claims becomes more certain, the relative level of margin maintained should decrease. In line with expectation the ultimate losses for prior years have decreased, however, the development tables show an increase. The increase in ultimate cost of claims is driven by foreign exchange movements.

22.4. Financial risk

The elements of Financial Risk below constitute the types of risk required for disclosure by FRS 102 section 34 Specialised Activities: Financial Institutions paragraph 23. This differs to how the Company identifies and evaluates risk. More information on how the Company manages its risk is outlined in Principle Risks and Uncertainties on page 5.

22.4.1(i) Credit risk

Credit risk is the risk of financial change in value due to actual credit losses deviating from expected credit losses due to the failure of another party to meet its contractual debt obligations. The principal source of credit risk arises from the inability of reinsurers to meet their contractual obligations if they become due.

The following policies and procedures are in place to mitigate the Company's exposure to credit risk:

- Robust governance structures with the Board setting headline risk appetites and cascading this down to the rest of the business, with relevant risk mitigation strategies implemented including robust controls and monitoring of key risk indicators.

- A credit risk policy and procedure document setting out the framework for what constitutes credit risk for the Company. The policy and procedure document is regularly reviewed for pertinence and for changes in the credit risk environment. Compliance with Company policies and procedures is monitored, and exposures and breaches are reported to the relevant Committee. All Committees meet on a regular basis, with exception meetings held if necessary.

- Ensuring counterparties are within risk appetite by dealing with companies that have a good credit rating or financial standing and active mitigation of credit risk by obtaining collateral or financial guarantees where necessary and thereafter ensuring appropriate monitoring.

Notes to the Financial Statements (continued)

22. Risk Management (continued)

22.4. Financial risk (continued)

22.4.1(i) Credit risk (continued)

- From an investment perspective, credit risk captures the potential loss due to default or migration to a lower rating. An Investment Management Policy sets out the assessment and determination of what constitutes credit risk (as a subset of market risk). Compliance with the policy is monitored; exposures and any breaches are reported to the Investment Committee. The policy is reviewed regularly. Limits are set for financial investments; a minimum overall average credit rating must be maintained in addition to minimum rating requirements per asset.

The table below shows the maximum exposure to credit risk (including an analysis of financial assets exposed to credit risk) for the components of the statement of financial position. Included within past due are balances of up to 9 months overdue. The Company policy is to write off any balances overdue by more than 9 months.

2018	Neither past due nor impaired $000	Past Due $000	Impaired $000	Total $000
Debt securities	2,437,327	-	-	**2,437,327**
Deposits with credit institutions	143,524	-	-	**143,524**
Deposits with ceding undertakings	59,453	-	-	**59,453**
Reinsurer' share of claims outstanding	890,217	-	-	**890,217**
Debtors arising out of direct insurance operations	304,898	59,117	(18,785)	**345,230**
Debtors arising out of reinsurance operations	517,608	69,091	-	**586,699**
Other debtors	1,879	-	-	**1,879**
Cash at bank and in hand	295,970	-	-	**295,970**
Total credit risk	**4,650,876**	**128,208**	**(18,785)**	**4,760,299**

2017	Neither past due nor impaired $000	Past Due $000	Impaired $000	Total $000
Debt securities	2,191,075	-	(1,674)	**2,189,401**
Deposits with credit institutions	163,077	-	-	**163,077**
Deposits with ceding undertakings	32,497	-	-	**32,497**
Reinsurer' share of claims outstanding	912,708	-	-	**912,708**
Debtors arising out of direct insurance operations	295,702	99,285	(18,785)	**376,202**
Debtors arising out of reinsurance operations	211,188	49,255	-	**260,443**
Other debtors	6,360	-	-	**6,360**
Cash at bank and in hand	174,066	-	-	**174,066**
Total credit risk	**3,986,673**	**148,540**	**(20,459)**	**4,114,754**

Notes to the Financial Statements (continued)

22. Risk Management (continued)

22.4. Financial risk (continued)

22.4.1(i) Credit risk (continued)

The tables below provide information regarding the credit risk exposure of the Company at 31 December 2018. Assets have been classified by way of a waterfall approach. Three rating agents are used in this analysis where possible. Where each of the three provides a rating, the median is selected. However, where at least two of the ratings are equivalent, the majority prevails. If only two ratings are provided, then prudence prevails and the lower of the two is selected. Where only one rating is obtainable, that rating is used. Internal ratings are then applied for those instances where an external rating does not exist.

22.4.1(ii) Credit risk - ratings

Debtors including other debtors, other than amounts due from outwards reinsurers, have been excluded from the table as these are not rated.

	Credit ratings relating to financial assets that are neither past due nor impaired						
	AAA	AA	A	BBB	<BBB	Not Rated	Total
2018	$000	$000	$000	$000	$000	$000	$000
Debt securities	477,164	436,097	627,728	889,687	6,651	-	**2,437,327**
Deposits with credit institutions	103,061	-	37,191	3,225	-	47	**143,524**
Deposits with ceding undertakings	-	-	57,438	-	-	2,015	**59,453**
Reinsurer' share of claims outstanding	-	119,796	727,909	9	-	42,502	**890,217**
Debtors arising out of reinsurance operations	-	23,020	56,999	-	-	2,473	**82,493**
Cash at bank and in hand	-	3,687	269,910	18,854	-	3,519	**295,970**
Total credit risk	**580,225**	**582,600**	**1,777,176**	**911,775**	**6,651**	**50,556**	**3,908,983**

	Credit ratings relating to financial assets that are neither past due nor impaired						
	AAA	AA	A	BBB	<BBB	Not Rated	Total
2017	$000	$000	$000	$000	$000	$000	$000
Debt securities	407,052	471,438	534,120	760,805	15,986	-	**2,189,401**
Deposits with credit institutions	103,098	-	31,521	5,807	-	22,651	**163,077**
Deposits with ceding undertakings	-	-	30,370	-	-	2,127	**32,497**
Reinsurer' share of claims outstanding	-	5,894	860,754	-	-	46,060	**912,708**
Debtors arising out of reinsurance operations	-	-	40,426	-	-	836	**41,262**
Cash at bank and in hand	-	5,212	161,825	1,063	-	5,966	**174,066**
Total credit risk	**510,150**	**482,544**	**1,659,016**	**767,675**	**15,986**	**77,640**	**3,513,011**

Notes to the Financial Statements (continued)

22. Risk Management (continued)

22.4. Financial risk (continued)

22.4.1(ii) Credit risk – ratings (continued)

Maximum Credit Exposure

It is the Company's policy to maintain accurate and consistent risk ratings across its credit risk portfolio. This enables management to focus on the applicable risks and comparison of credit exposures. The attributable financial ratings are assessed and updated regularly. During the year all live counterparties were within acceptable limits and had acceptable ratings, there were no breach of set limits.

The Company actively manages its product mix to ensure that there is no significant concentration of credit risk.

Collateral

Credit Risk is also mitigated by entering into collateral agreements. The Investment Committee monitors the market value, credit quality and asset type of the collateral. The amount and type of collateral required depends on an assessment of the credit risk of the counterparty, with the relevant procedures being completed and management having to give sign off regarding the acceptability of types of collateral and the value of collateral held. These arrangements are then monitored to ensure parameters are adhered to and valuations or ratings continue to be acceptable. Collateral was held in the form of either Letters of Credit or funds held within designated accounts. Please refer to note 24 for more information.

22.4.2 Liquidity risk

Liquidity risk is the probability of loss arising from situations where the Company either has insufficient cash to meet its financial obligations or is required to sell assets below their fair value to meet cash demands.

Liquidity risk is mitigated through the use of asset-liability modelling and through the maintenance of a diversified and appropriately liquid portfolio of assets.

LMIE holds capital to cover the risk that assets are required to be liquidated below book value in a stressed (1 in 200 year) scenario, as well as balancing the liquidity of the investment portfolio.

Based on a review of the historic liquidity of assets in stressed scenarios, LMIE will ensure that the weighting of bonds within liquidity tiers 1 & 2 (defined as highly liquid assets and securities that are generally liquid that can still trade at prevailing price levels during periods of modest market stress respectively) will exceed 85% of the total investment portfolio.

The Company will maintain a diversified and appropriately liquid portfolio aimed at minimising the mismatch in cash flows between the assets and net-liabilities. Illiquid investments will be considered on a case-by-case basis depending on the supporting justification; these securities will be subject to regular review to ensure the impact on liquidity risk is immaterial.

The table below summarises the maturity profile of the Company's financial liabilities based on remaining undiscounted contractual obligations, including interest payable, and outstanding claim liabilities based on the estimated timing of claim payments resulting from recognised insurance liabilities.

Notes to the Financial Statements (continued)

22. Risk Management (continued)

22.4. Financial risk (continued)

22.4.2 Liquidity risk (continued)

2018	0-1 year $000	1-3 years $000	3-5 years $000	>5 years $000	Total $000
Outstanding claim liabilities	280,414	1,154,339	611,576	500,598	2,546,927
Creditors	365,956	-	-	-	365,956
Total credit risk	**646,370**	**1,154,339**	**611,576**	**500,598**	**2,912,883**

2017	0-1 year $000	1-3 years $000	3-5 years $000	>5 years $000	Total $000
Outstanding claim liabilities	582,755	1,013,142	517,302	356,149	2,469,348
Creditors	269,814	-	-	-	269,814
Total credit risk	**852,569**	**1,013,142**	**517,302**	**356,149**	**2,739,162**

22.4.3 Market risk

Market risk is the risk of fluctuations to the net asset value (NAV) due to the volatility or level of financial variables impacting primarily the value of fixed income securities and private equity funds and the discounted value of net-liabilities. Market risk is comprised of:

- Currency risk;
- Equity risk;
- Credit and Spread risk;
- Interest rate risk.

The following policies and procedures are in place to govern the exposure to market risk:

- An Investment Management Policy exists that sets out the assessment and determination of what constitutes market risk for the Company.
- The Investment Management Policy details how the Company measures, monitors and mitigates the potential market risks posed by the investment portfolio. Compliance with the policy is monitored with exposures and any breaches reported to the Investment Committee and the Risk Committee. The policy is reviewed regularly for pertinence and for changes in the risk environment.
- The measurement, monitoring and reporting of market risk takes into account the profile of the net technical provisions and is reflective of the financial risk caused by the interaction of the assets and liabilities.

Notes to the Financial Statements (continued)

22. Risk Management (continued)

22.4. Financial risk (continued)

22.4.3 Market risk (continued)

22.4.3(i) Currency risk

Currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.

The Company's functional currency is the USD and its exposure to foreign exchange risk arises primarily with respect to transactions in Euro, GBP and Other Currencies. The Company seeks to mitigate the risk by matching foreign currency denominated liabilities with assets denominated in the same currency.

The table below summarises the exposure of the financial assets and liabilities to foreign currency exchange risk at the reporting date, as follows:

2018	GBP $000	USD $000	EUR $000	OTH $000	Total $000
Financial investments	466,434	1,589,354	457,825	81,181	2,594,794
Reinsurers' share of technical provisions	206,488	767,735	279,877	10,048	1,264,148
Insurance and reinsurance receivables	155,054	553,215	194,763	28,896	931,928
Cash and cash equivalents	10,945	209,618	45,639	29,768	295,970
Other assets	177,459	205,650	101,288	- 291	484,106
Total assets	**1,016,380**	**3,325,572**	**1,079,392**	**149,602**	**5,570,946**
Technical provisions	909,368	1,838,279	952,593	102,936	3,803,176
Insurance and reinsurance payables	72,727	131,653	91,934	12,098	308,412
Other creditors	41,740	131,725	32,495	19,014	224,974
Total liabilities	**1,023,835**	**2,101,657**	**1,077,022**	**134,048**	**4,336,562**
Net Assets	**(7,455)**	**1,223,915**	**2,370**	**15,554**	**1,234,384**

2017	GBP $000	USD $000	EUR $000	OTH $000	Total $000
Financial investments	524,034	1,413,672	357,010	74,590	2,369,306
Reinsurers' share of technical provisions	270,932	560,911	326,666	39,633	1,198,142
Insurance and reinsurance receivables	113,570	310,759	186,109	26,207	636,645
Cash and cash equivalents	15,591	97,910	22,783	37,782	174,066
Other assets	113,907	156,238	69,351	10,581	350,077
Total assets	**1,038,034**	**2,539,490**	**961,919**	**188,793**	**4,728,236**
Technical provisions	872,778	1,478,010	931,690	134,427	3,416,905
Insurance and reinsurance payables	88,531	2,371	98,052	9,381	198,335
Other creditors	20,054	112,772	36,490	11,941	181,257
Total liabilities	**981,363**	**1,593,153**	**1,066,232**	**155,749**	**3,796,497**
Net Assets	**56,671**	**946,337**	**(104,313)**	**33,044**	**931,739**

Notes to the Financial Statements (continued)

22. Risk Management (continued)

22.4. Financial risk (continued)

22.4.3 Market risk (continued)

22.4.3(i) Currency risk (continued)

The table below gives an indication of the impact on net asset value of a percentage change in the relative strength of the USD against GBP and Euro:

	2018 $000	2017 $000
Dollar weakens:		
10% against other currencies	(565)	(5,294)
20% against others currencies	(1,271)	(11,911)
Dollar strengthens:		
10% against other currencies	462	4,331
20% against others currencies	847	7,940

22.4.3(ii) Interest rate risk

Interest rate risk is the risk of fluctuations to the net asset value (NAV) due to movements in the term structure of the risk-free rate.

The Market and Liquidity Risk Policy constrains the manager to a maximum loss that can be suffered as the result of an interest rate risk mismatch between the assets and net-liabilities. The Company has no significant concentration of interest rate risk.

The analysis below is performed for reasonably possible movements in interest rates, taking into account the term structure, with all other variables held constant, showing the impact on equity of the effects of changes in interest rates on the market value of all invested assets exposed to interest rate risk.

This measures the impact on equity (for available for sale investments) that would arise from a reasonably possible change in interest rates at the reporting date on financial instruments at the period end.

The correlation of variables will have a significant effect in determining the ultimate impact on interest rate risk, but to demonstrate the impact due to changes in variables, the variables were altered on an individual basis. It should be noted that real-world movements in these variables are non-linear.

Notes to the Financial Statements (continued)

22. Risk Management (continued)

22.4. Financial risk (continued)

22.4.3 Market risk (continued)

22.4.3(ii) Interest rate risk (continued)

Changes in variables	Impact on OCI $000	Impact on equity $000
At 31 December 2018		
+ 50 basis points	(9,535)	(9,535)
- 50 basis points	9,698	9,698
+ 100 basis points	(18,906)	(18,906)
- 100 basis points	19,557	19,557
At 31 December 2017		
+ 50 basis points	(37,266)	(37,266)
- 50 basis points	47,719	47,719
+ 100 basis points	(78,168)	(78,168)
- 100 basis points	91,872	91,872

22.4.3(iii) Equity risk

Equity risk arises from the level or volatility of market prices for equities.

The company's equity risk exposure relates to financial assets and financial liabilities whose values will fluctuate as a result of changes in market prices, principally investment securities.

The Investment Management Policy governs the management of equity risk by setting limits on equity investments which are regularly monitored.

There is no significant concentration of equity risk.

The analysis below is performed for reasonably possible movements in market indices on financial instruments with all other variables held constant, showing the impact on profit before tax due to changes in fair value of financial assets (whose fair values are recorded in the profit and loss account). The correlation of variables will have a significant effect in determining the ultimate impact on equity risk, but to demonstrate the impact due to changes in variables, the variables were altered on an individual basis. It should be noted that real-world movements in these variables are non-linear.

The method used for deriving sensitivity information and significant variables did not change from the previous period.

		2018		2017	
Changes in prices	Change in variables $000	Impact on profit before tax $000	Impact on equity $000	Impact on profit before tax $000	Impact on equity $000
Shares & other variable - yield securities	+10%	1,394	1,162	1,683	1,402
Shares & other variable - yield securities	-10%	(1,394)	(1,162)	(1,683)	(1,402)

Notes to the Financial Statements (continued)

23. Other obligations including leases

Future minimum rentals payable under operating leases rechargeable from LSML to the Company are as follows:

	2018 $000	2017 $000
Not later than one year	6,237	7,062
Later than one year and not later than five years	21,996	23,110
Later than five years	41,173	46,281
	69,406	**76,453**

Total operating lease expense for the year amounted to $7,018k (2017: $6,381k). This is included within administrative expenses shown in note 4.

24. Other commitments

Collateral deposits

Debt securities and deposits with credit institutions amounting to $230,938k (2017: $146,776k) have been pledged as security in connection with certain of the Company's overseas liabilities.

25. Off-balance sheet arrangements

The Company benefits from collateral pledged by counterparties, which is not held on the balance sheet. The collateral is held in segregated funds, and acts as additional security in the event of failure of those counterparties to meet their contractual obligations.

The Company has not been party to any other arrangements, which is not reflected in its statement of financial position, where material risk and benefits arise for the Company.

26. Related Parties

As a qualifying entity, the Company has elected to take advantage of the exemption from the requirements of FRS 102 Section 33 Related Party Transactions paragraph 1A and paragraph 7 to not disclose related party transactions with key management personnel and related party transactions with wholly owned subsidiaries of Liberty International Holdings Incorporated (DE).

There were no outstanding balances as at 31 December 2018 (2017: nil) other than the balances reported in notes 10,11,18 and 19. The balances reported in these note relate to balances with entities under common control of the ultimate parent.

27. Guarantees

On 15 February 2002 the board of Liberty Mutual Insurance Company agreed to grant a guarantee covering the Company's insurance obligations. This was ratified by the Massachusetts' Department of Insurance on 10 May 2002. The original guarantee was updated and re-issued on 13 April 2006.

28. Events after the balance sheet date

As noted in the Strategic Report and the Directors' Report, the Company has taken steps to minimise the uncertainly around Brexit in 2019. As the outcome of Brexit unfolds, the Company believes it is well positioned to deal with the both the leave and the extension scenarios.

The company re-domiciled to Luxembourg on 1 March 2019. As a result, the Company's accounts for the year ending 31 December 2019 will be prepared under Luxembourg GAAP. No material changes are expected between UK GAAP and Luxembourg GAAP.

Notes to the Financial Statements (continued)

28. Events after the balance sheet date (continued)

In addition, the Company received a capital injection of $200m on 29 March 2019 to support the growth plans.

The above events are non-adjusting events in nature in respect of the financial year ended 31 December 2018.

29. Ultimate parent Company

The ultimate parent Company is Liberty Mutual Holding Company Inc. of Boston, 175 Berkeley Street, Boston, Massachusetts 02117, U.S.A. a Company incorporated in the United States of America. The smallest higher group of companies for which group accounts are drawn up and of which this Company is a member is Liberty International Holdings Incorporated, a Company incorporated and registered in the U.S.A.

The immediate parent Company of Liberty Specialty Markets Holdco SL.

Copies of the group accounts of Liberty International Holdings Incorporated and of Liberty Mutual Holding Company Inc. of Boston are available from the companies' registered office, 175 Berkeley Street, Boston, Massachusetts 02117, U.S.A.