

# Markel International Insurance Company Limited

Solvency and Financial Condition Report for  
the year ended December 31, 2016



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## Board of Directors

Ralph C Snedden (Chairman)  
Jeremy W Brazil  
Andrew J Davies  
Paul H Jenks  
Nicholas J S Line  
Hugh A J Maltby  
Ian Marshall  
Jeremy A Noble  
Hannah E Purves (appointed 1 May 2017)  
John W J Spencer  
William D Stovin  
Anne Whitaker  
Simon Wilson (appointed 2 May 2017)

## Statement of Directors' Responsibilities

We acknowledge our responsibility for preparing the Markel International Insurance Company Limited ("MIICL") Solvency and Financial Condition Report in all material respects in accordance with the PRA rules and Solvency II regulations.

We are satisfied that:

- Throughout the financial year in question, MIICL has complied in all material respects with the requirements of the PRA rules and the Solvency II regulations as applicable to the Company; and
- It is reasonable to believe that MIICL has continued so to comply subsequently and will continue so to comply in future.

On behalf of the Board



**Jeremy A Noble**

Director  
London

19 May 2017

## **Report of the external independent auditor to the Directors of Markel International Insurance Company Limited (“MIICL” or “the Company”) pursuant to Rule 4.1 (2) of the External Audit Chapter of the PRA Rulebook applicable to Solvency II firms**

Except as stated below, we have audited the following documents prepared by MIICL as at 31 December 2016:

- The ‘Valuation for solvency purposes’ and ‘Capital Management’ sections of the Solvency and Financial Condition Report of MIICL as at 31 December 2016 (**‘the Narrative Disclosures subject to audit’**); and
- Company templates S02.01.02, S.12.01.02, S17.01.02, S23.01.01 and S28.01.01 (**‘the Templates subject to audit’**).

The Narrative Disclosures subject to audit and the Templates subject to audit are collectively referred to as the **‘Relevant Elements of the Solvency and Financial Condition Report’**.

We are not required to audit, nor have we audited, and as a consequence do not express an opinion on the Other Information which comprises:

- Information contained within the Relevant Elements of the Solvency and Financial Condition Report set out above which are, or derive from the Solvency Capital Requirement, as identified in the Appendix to this report; and
- The ‘Business and performance’, ‘System of governance’ and ‘Risk profile’ sections of the Solvency and Financial Condition Report; and
- Company templates S.05.01.02, S.05.02.01, S19.01.21, S.25.03.01; and
- The written acknowledgement by the Directors of their responsibilities, including for the preparation of the solvency and financial condition report (**‘the Responsibility Statement’**).

To the extent the information subject to audit in the Relevant Elements of the Solvency and Financial Condition Report includes amounts that are totals, sub-totals or calculations derived from the Other Information, we have relied without verification on the Other Information.

### **Respective responsibilities of directors and auditor**

As explained more fully in the Responsibility Statement, the Directors are responsible for the preparation of the Solvency and Financial Condition Report in accordance with the financial reporting provisions of the PRA rules and Solvency II regulations.

The Directors are also responsible for such internal control as they determine is necessary to enable the preparation of a Solvency and Financial Condition Report that is free from material misstatement, whether due to fraud or error.

Our responsibility is to audit, and express an opinion on, the Relevant Elements of the Solvency and Financial Condition Report in accordance with applicable law and International Standards on Auditing (UK and Ireland) together with ISA (UK) 800 and ISA (UK) 805. Those standards require us to comply with the Auditing Practices Board’s Ethical Standards for Auditors.

## **Scope of the audit of the Relevant Elements of the Solvency and Financial Condition Report**

A description of the scope of an audit is provided on the Financial Reporting Council's website at [www.frc.org.uk/auditscopeukprivate](http://www.frc.org.uk/auditscopeukprivate).

## **Opinion on the Relevant Elements of the Solvency and Financial Condition Report**

In our opinion, the information subject to audit in the Relevant Elements of the Solvency and Financial Condition Report of MIICL as at 31 December 2016 is prepared, in all material respects, in accordance with the financial reporting provisions of the PRA Rules and Solvency II regulations on which they are based, as modified by relevant supervisory modifications, and as supplemented by supervisory approvals and determinations.

## **Emphasis of Matter - Basis of Accounting**

We draw attention to the 'Valuation for solvency purposes' section of the Solvency and Financial Condition Report, which describes the basis of accounting. The Solvency and Financial Condition Report is prepared in compliance with the financial reporting provisions of the PRA Rules and Solvency II regulations, and therefore in accordance with a special purpose financial reporting framework. The Solvency and Financial Condition Report is required to be published, and intended users include but are not limited to the Prudential Regulation Authority. As a result, the Solvency and Financial Condition Report may not be suitable for another purpose. Our opinion is not modified in respect of this matter.

## **Other Matter**

The Company has authority to calculate its Solvency Capital Requirement using an internal model ("the Model") approved by the Prudential Regulation Authority in accordance with the Solvency II Regulations. In forming our opinion (and in accordance with PRA Rules), we are not required to audit the inputs to, design of, operating effectiveness of and outputs from the Model, or whether the Model is being applied in accordance with the Company's application or approval order.

## **Matters on which we are required to report by exception**

In accordance with Rule 4.1 (3) of the External Audit Chapter of the PRA Rulebook for Solvency II firms we are also required to consider whether the Other Information is materially inconsistent with our knowledge obtained in the audit of MIICL's statutory financial statements. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

## **The purpose of our audit work and to whom we owe our responsibilities**

This report of the external auditor is made solely to the company's directors, as its governing body, in accordance with the requirement in Rule 4.1(2) of the External Audit Part of the PRA Rulebook and the terms of our engagement. We acknowledge that the directors are required to submit the report to the PRA, to enable the PRA to verify that an auditor's report has been commissioned by the company's directors and issued in accordance with the requirement set out in Rule 4.1(2) of the External Audit Part of the PRA Rulebook and to facilitate the discharge by the PRA of its regulatory functions in respect of the company, conferred on the PRA by or under the Financial Services and Markets Act 2000.

Our audit has been undertaken so that we might state to the company's directors those matters we are required to state to them in an auditor's report issued pursuant to Rule 4.1(2) 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 through its governing body, for our audit, for this report, or for the opinions we have formed.



KPMG LLP  
15 Canada Square  
Canary Wharf  
London  
E14 5GL

19 May 2017

The maintenance and integrity of MIICL's website 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 Solvency and Financial Condition Report since it was initially presented on the website.

Legislation in the United Kingdom governing the preparation and dissemination of Solvency and Financial Condition Reports may differ from legislation in other jurisdictions.



## **Appendix – relevant elements of the Solvency and Financial Condition Report that are not subject to audit**

### **Solo internal model**

The relevant elements of the Solvency and Financial Condition Report that are not subject to audit comprise:

- The following elements of template S.02.01.02:
  - Row R0550: Technical provisions - non-life (excluding health) - risk margin
  - Row R0590: Technical provisions - health (similar to non-life) - risk margin
  - Row R0640: Technical provisions - health (similar to life) - risk margin
  - Row R0680: Technical provisions - life (excluding health and index-linked and unit-linked) - risk margin
  - Row R0720: Technical provisions - Index-linked and unit-linked - risk margin
  
- The following elements of template S.17.01.02
  - Row R0280: Technical provisions calculated as a sum of BE and RM - Risk margin
  - Rows R0290 to R0310 – Amount of transitional measure on technical provisions
  
- The following elements of template S.23.01.01
  - Row R0580: SCR
  - Row R0740: Adjustment for restricted own fund items in respect of matching adjustment portfolios and ring fenced funds
  
- The following elements of template S.28.01.01
  - Row R0310: SCR
  
- Elements of the Narrative Disclosures subject to audit identified as 'unaudited'.

# 1 Summary

The Directors submit their Solvency and Financial Condition Report ("SFCR") for MIICL for the year ended 31 December 2016.

SII is an EU Directive aimed at providing a harmonised insurance regulatory regime for the European insurance industry in order to promote policyholder protection and a more resilient sector. It became effective from 1 January 2016. This SFCR comprises MIICL's solo submission in accordance with those rules.

Under SII, an insurer can apply for use of an internal model in order to calculate the amount of capital it needs to hold, in recognition of the risks it faces. Insurers that do not use an internal model will have their capital requirements set using the standard formula.

On 5 December 2015, the PRA granted MIICL approval to use a full internal model to calculate its capital requirements and this approval was effective from the implementation of SII on 1 January 2016.

As at 31 December 2016 MIICL had eligible SII capital resources of \$670.0m (section 6.1.5) against a Solvency Capital Requirement of \$323.2m (section 6.2), representing a coverage ratio of 207.3%.

<b>Summary of Solvency Coverage</b>	<b>\$'000</b>
SII Eligible Own Funds	670,029
SCR	323,188
MCR	108,750
<b>Surplus over SCR</b>	<b>346,841</b>
Surplus over MCR	561,279
<b>Coverage over SCR</b>	<b>207.3%</b>
Coverage over MCR	616.1%

## 2 Business and Performance

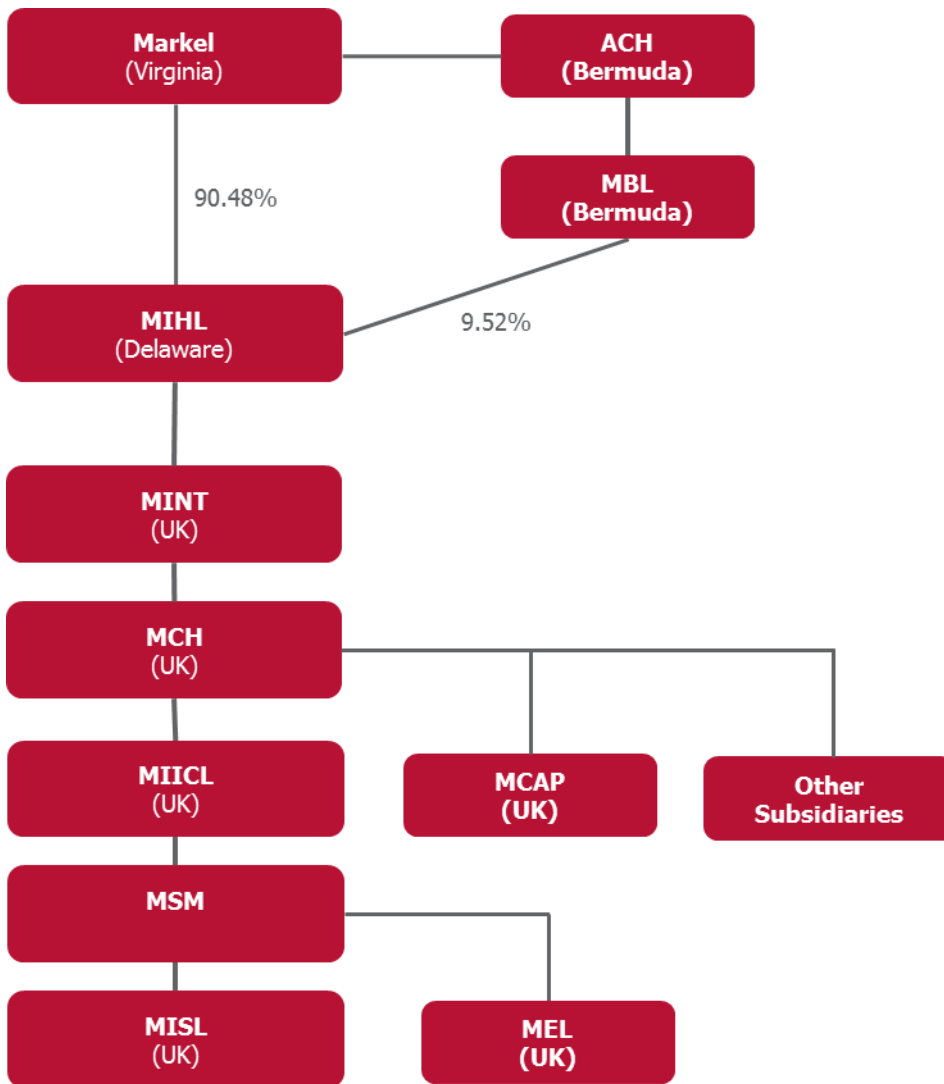
### 2.1 Company Information

<b>Name &amp; Legal Form</b>	Markel International Insurance Company Limited 20 Fenchurch Street London EC3M 3AZ
<b>Registered Number</b>	966670
<b>Legal Entity Identifier</b>	549300HRELQKZ62ZP423
<b>Supervisory Authorities</b>	Prudential Regulation Authority, 20 Moorgate, London, EC2R 6DA  Financial Conduct Authority, 25 The North Colonnade, London, E14 5HS
<b>External Auditor</b>	KPMG LLP 15 Canada Square London E14 5GL
<b>Immediate Parent</b>	Markel Capital Holdings Limited
<b>Ultimate Holding Company</b>	Markel Corporation
<b>Subsidiaries</b>	Markel Syndicate Management Limited (100% owned by MIICL) Markel International Services Limited (100% owned by MSM) Markel Europe Limited (100% owned by MSM)

#### 2.1.1 Group structure

MIICL is a subsidiary MCH, which is incorporated in the UK. Its ultimate holding company is Markel, which is incorporated in Virginia, in the United States and its ultimate European Economic Area ("EEA") parent company is MINT. MINT includes both MIICL and Syndicate 3000.

Set out below is a simplified extract of the group structure for Markel showing MIICL, MCH, MINT and Markel.



**All holdings are 100% unless indicated otherwise**

### 2.1.2 Group Supervision

The PRA is the group supervisor of MINT and, under SII, is the group supervisor of Markel as the US is not an equivalent country for SII group supervision purposes. In the absence of equivalence, Markel is subject to full SII group supervision or MIICL can apply to use "other methods" as permitted under Article 262(2) of the SII Directive. On 17 December 2015, the PRA granted MIICL a waiver modifying Rule 20.1 of the PRA handbook (Group Supervision), allowing it to apply "other methods" in accordance with the SII Directive. Under the terms of the waiver, the Company is required to provide certain information to the PRA, including the following:

- Annual return (10k) and quarterly returns (10Q) representing Markel on a consolidated basis as filed with the Securities and Exchange Commission.
- Markel ORSA as required by the Illinois Department of Insurance, the lead State Regulator for Markel.

## 2.2 Business

MIICL's principal activity is the transaction of general insurance from its office in London and its branch operations in Spain, Sweden, the Netherlands, Germany, Ireland and Switzerland, in addition to overseas operations in Latin America and Dubai. Markel (UK) Limited also underwrites on behalf of the Company through its UK branch network.

MIICL holds Surplus Lines Licences and is an accredited reinsurer in most US States. It is also able to underwrite general insurance and reinsurance in a number of other overseas territories.

The Company operates six underwriting units, namely Marine, Energy & Property; Specialty & Financial Lines; Reinsurance; Global Insurance; National Markets and Latin America:

### 2.2.1 Marine, Energy & Property

A worldwide portfolio including marine primary and excess coverage for liability, hull, war, terrorism, specie, ports and terminals, marine trades, subsea and cargo risks; upstream and midstream oil and gas risks; and a broad range of property open market facultative business.

#### **Marine**

Coverage includes primary and excess coverage for liability, hull, war, terrorism, specie and cargo risks worldwide, handling a comprehensive range of risks for multinational companies, national industries and private individuals.

The cargo account comprises a broad portfolio of transit and storage risk covering most industries on a global basis. The hull account covers physical damage to ocean-going tonnage, yachts, building risks and mortgagee's interest. The liability account provides coverage for a broad range of energy liabilities. The terrorism account covers physical damage resulting from terrorism, strike, riots, war and political violence.

The war account offers coverage for marine and aviation war across all vessel types and tonnages. The specie account includes coverage for fine art, exhibition business and other aspects of valuable item insurance.

#### **Energy**

Offers coverage on a worldwide basis for all aspects of upstream and midstream oil and gas activities. Coverage includes business interruption or loss of production income, construction of energy related structures, control of well and physical damage to installations.

#### **Property Open Market**

A facultative book of business across all classes of property, worldwide. Close working relationships are formed with clients and brokers to facilitate innovative and flexible solutions to meet their insurance needs.

### 2.2.2 Specialty & Financial Lines

A worldwide portfolio of primary and excess coverage for personal accident, contingency and entertainment, equine and livestock, professional and financial risks, and trade credit and political risk.

#### **Personal Accident, Contingency and Entertainment**

The personal accident account focuses upon professional sports, locum schemes, affinity, high net worth and entrepreneurs and business travel.

The contingency team underwrites a broad spectrum of London market non-appearance and event cancellation business.

The entertainment account offers both employers' liability and public liability insurance for companies involved in film shoots. Clients tend to be UK based but the shoots can take place all over the world giving the book a truly global feel.

#### **Equine and Livestock**

This team underwrites equine, livestock and liability insurance with a diverse range of coverage for bloodstock and livestock worldwide.

The equine account offers coverage for the widest range of needs from individual horse owners up to the largest breeding and racing operations.

The livestock account provides individually tailored insurance solutions for the largest livestock companies, having operations in several countries. Coverage includes cattle, zoos and aquaria, poultry, pigs and animals in transit.

The liability account provides cover for equine and livestock related liability risks for private instructors, private horse owners, riding establishments and other equine related liability risks as well as livestock related liability on farm risks.

### **Professional and Financial Risks**

This team underwrites professional indemnity, management liability, emerging risks and financial institutions insurance. The professional indemnity account services most core and regulated professions including accountants, architects, engineers and financial advisors.

The management liability account spans a wide range of industries and coverage includes directors' and officers' liability (D&O), employment practices liability and limited liability partnership cover.

The emerging risks account covers a variety of exposures including cyber (privacy, data breach and electronic risks); errors and omissions; general liability and intellectual property rights infringements (patents), across multiple industries and sectors.

Financial institutions insurance can provide cover on a stand-alone basis or as a blended package to include bankers blanket bond, professional indemnity and D&O, depending on the clients requirements.

The Professional and Financial Risks team writes business on a worldwide basis, limiting exposure in the United States.

### **Trade Credit and Political Risk**

This team underwrites trade credit and political risk and contract frustration insurance, protecting sellers worldwide from the risk of buyer insolvency and other forms of counterparty risk.

The trade credit account coverage includes prepayment cover, insolvency and default, captive reinsurance, syndicated co-insurance solutions and financial institutions. Policies are designed to provide clients with certainty of cover and are underwritten with the aim of establishing a long-term partnership with the insured.

The political risk and contract frustration account has a broad range of coverage including insolvency or default by either a public or privately owned entity, licence cancellation, aircraft and vessel repossession, mortgage rights insurance and currency inconvertibility and exchange transfer.

#### **2.2.3 Reinsurance**

This unit includes international casualty treaty plus international and North American property treaty business.

### **Casualty Treaty**

The casualty treaty team underwrites a diversified account, including general liability, professional indemnity, directors' and officers' liability and medical malpractice. The portfolio is worldwide, excluding United States domiciled business.

### **Property Treaty**

Property treaty reinsurance is provided on an excess of loss and proportional basis for per risk and catastrophe exposures. The property treaty account covers a wide diversity of exposures in the US and internationally, which can be tailored to meet the specific needs of cedants.

#### **2.2.4 Global Insurance**

Global Insurance is focused on large accounts and complex risks, providing casualty, professional liability, marine and property coverage for privately-held companies and publicly-traded companies.

#### **2.2.5 National Markets**

The National Markets unit comprises business written by Markel (UK) Limited, MIICL's branch operations and Abbey Protection Group ("Abbey").

The team underwrite a full range of professional liability products, including professional indemnity, D&O and employment practices liability. In addition, coverage is provided for small to medium-sized commercial property risks on both a stand-alone and package basis. The branch offices provide insureds and brokers

with direct access to decision-making underwriters who possess specialised knowledge of their local markets. The unit also underwrites certain niche liability products such as coverages for social welfare organisations.

Abbey sells and underwrites insurance products which provide protection against legal expenses and other professional fees incurred by clients as a result of legal actions and HMRC investigations.

### 2.2.6 Latin America

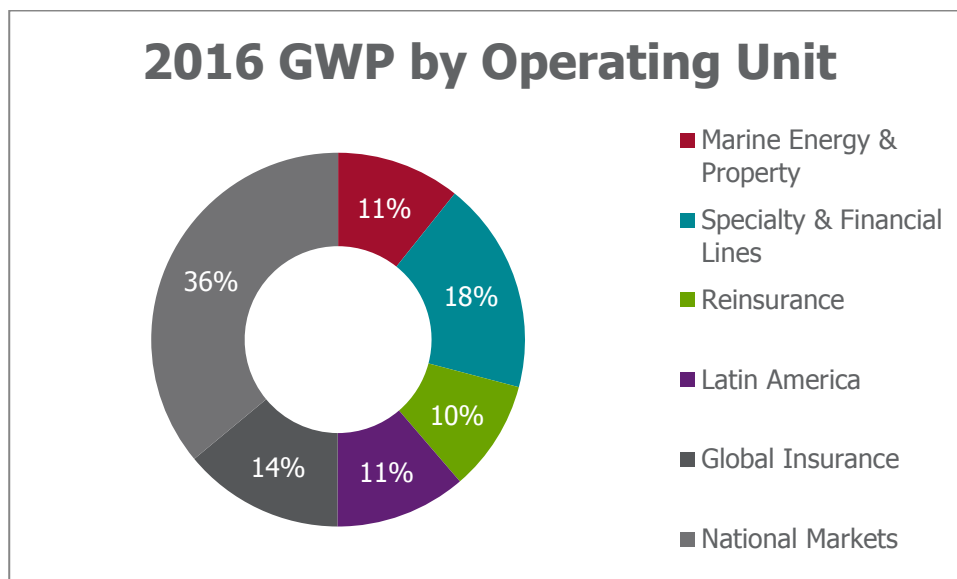
The Company's operations in Latin America transact reinsurance business on a range of product lines including accident and health, property and surety.

## 2.3 Business during 2016

### 2.3.1 Analysis of business by operating segment and SII line of business

MIICL reported Gross Written Premiums ("GWP") of \$451.4m in its Financial Statements for the year ended 31 December 2016. These financial statements were prepared on a UKGAAP basis in accordance with FRS102.

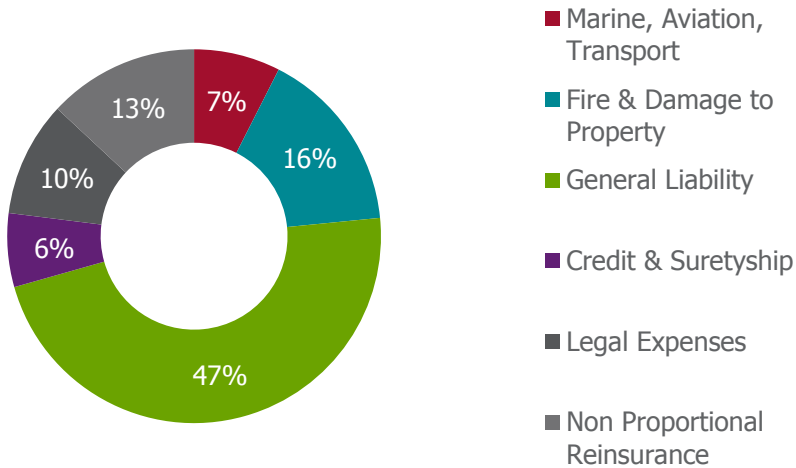
Set out below is a summary of GWP by operating unit. No comparison to 2015 is provided as that is prior to the start of the SII Directive.



SII requires business to be categorised into 16 standardised lines of business ("Lob"). The management reporting classes within each operating unit represent the homogeneous risk groups and these largely map to SII Lobs on a 'one to one' or 'many to one' basis.

Set out below is a summary of GWP by SII Lob (further analysis is provided in Appendix 2). No comparison to 2015 is provided as that is prior to the start of the SII Directive. The "Other" Lob primarily comprises Credit & Suretyship and Income Protection business.

## 2016 GWP by SII Lob

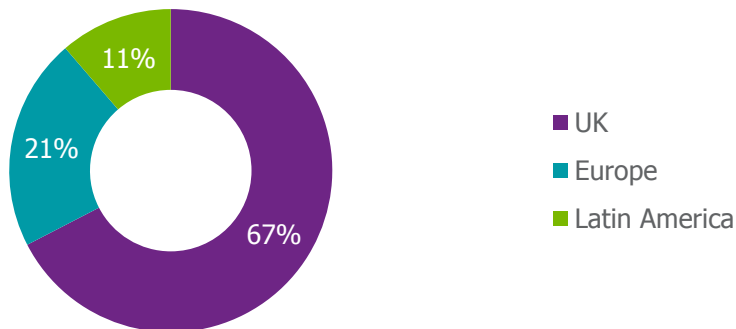


### 2.3.2 Analysis by geographic area

The majority of MIICL's business is written in the UK and at its European and Latin America branch operations, whilst the location of risks is in various different countries.

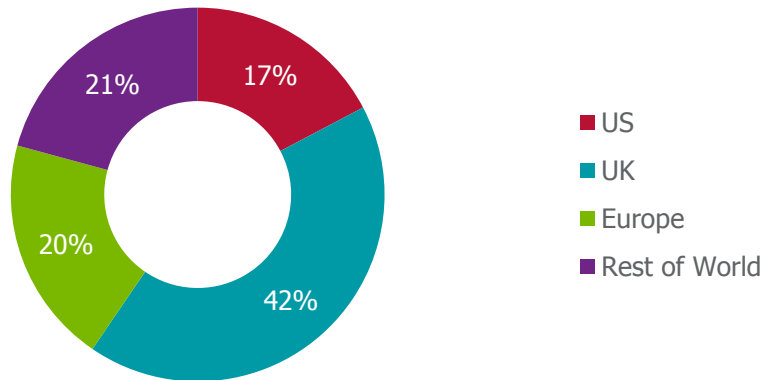
Set out below is a summary geographic analysis of the location of underwriting and location of risk for MIICL's 2016 GWP.

## 2016 GWP by location of underwriting





## 2016 GWP by location of risk



### 2.4 Changes during 2016

#### 2.4.1 Classes of Business

For 2016 there were no material additions to the classes of business previously offered. MIICL strengthened the Hull underwriting team to include more specialist Subsea expertise. In addition the Trade Credit offering has been expanded to include political risk following the recruitment of the relevant expertise.

#### 2.4.2 Restructuring of Wholesale divisions

As part of its plans to meet its long-term targets, MINT restructured its London wholesale business into three divisions (Specialty & Financial Lines, Marine, Energy & Property and Reinsurance divisions) from the previous six. The change in structure was designed to meet the needs of MINT's broking clients, to improve day to day efficiencies in the running of the business and to support a larger business without adding significant additional cost. At the same time, it focuses the energies of our front line teams on underwriting, while putting in place a standardised, scalable operating structure capable of supporting a business growing both organically and by acquisition.

The new wholesale structure is resulting in significant benefits especially in the areas of planning and reserving without any reduction in the control environment. The Company's Risk Framework only required minor adjustments to reflect the revised London Wholesale underwriting structure.

#### 2.4.3 International Growth

There were no significant international developments during 2016. However, as stated above, MIICL continues to seek to grow and develop its business and international presence where there are perceived opportunities for profitable development.

#### 2.4.4 Brexit

On 23 June 2016 the UK voted to leave the EU. Article 50 of the Lisbon Treaty sets out a framework, lasting up to two years, for the negotiation of the details of the restructuring of the United Kingdom's relationship with the EU. The article was invoked on March 29, 2017.

The effects of Brexit will depend on any agreement the UK makes to retain access to EU markets either during a transitional period or more permanently. Brexit could impair or end the ability of the Company to transact business in EU countries from our UK office and the Company's ability to maintain its current branches in EU countries.

The Directors are considering whether to establish an insurance carrier in an EU member country, in order to continue transacting EU business if UK access to EU markets ceases, or is materially impaired.

### 2.4.5 Entity Quota Share

MIICL underwrites a reinsurance contract with the Syndicate, the "Entity Quota Share" ("EQS"), whereby some of the Syndicate's natural catastrophe risk is reinsured by MIICL. This contract has been amended over time. The internal model was used to consider various permutations and the resulting capital requirements and exposure levels from potential variations. In 2016 the Board amended the terms of the EQS, including a reduction in Catastrophe exposure to MIICL.

### 2.4.6 1992 & Prior

On March 9, 2015, with the exception of one specific account, MIICL entered into agreements with a third party to reinsure its remaining liabilities and exposures relating to business underwritten with respect to 1992 and all prior underwriting years. With effect from March 18, 2015, the third party took over the management of claims and all future administration relating to these liabilities and exposures. The final court hearing took place on March 23, 2017. The court approved a Part VII transfer, with an effective date of March 31, 2017.

## 2.5 Underwriting Performance

### 2.5.1 Analysis by SII Line of Business

QRT S.05.01.02 (Appendix 2) provides a detailed analysis of the UKGAAP underwriting result for the year ended December 31, 2016 by SII line of business. Set out below is a summary of the key classes.

As discussed in MIICL's Financial Statements, the Company reported an underwriting profit of \$34.6m for the year, having benefitted from lower than expected large loss and catastrophe activity during the year. This represents a combined ratio of 90.7%.

The result included a release from prior year reserves of \$83.8m. This release was as a result of more favourable claims development than originally anticipated and the work of the claims department in dealing with claims in an expeditious manner.

	Marine, Aviation, Transport \$'m	Fire & Damage to Property \$'m	General Liability \$'m	Other \$'m	Non Prop RI \$'m	Total \$'m
Gross written premiums	33.8	72.0	212.9	73.8	58.9	451.4
Net written premiums	26.4	67.6	150.2	66.6	52.2	363.0
Net earned premiums	28.5	66.0	149.8	65.4	62.4	372.1
Underwriting result before expenses	19.8	34.2	86.0	36.4	38.3	214.7
Expenses						(180.1)
<b>Underwriting result</b>						<b>34.6</b>
Loss and LAE ratio	30.5%	48.2%	42.6%	44.3%	38.6%	42.3%
Expense ratio						48.4%
<b>Combined ratio</b>						<b>90.7%</b>

### 2.5.2 Analysis by geographic area

An analysis of the underwriting result by country is provided in QRT S.05.02.01 (Appendix 3). In accordance with the Commission Implementing Regulation, the country selection has been prepared on a mixture of location of risk and location of underwriting:

- **By location of risk:** for Income Protection, Fire & Damage to Property, Credit and Suretyship
- **By location of underwriting:** for MAT, GL and Legal Expenses
- **By location of cedant:** for all assumed reinsurance

	UK & Other \$'m	Europe* \$'m	Colombia \$'m	Total \$'m
Gross written premiums	338.1	84.9	28.4	451.4
Net written premiums	275.4	60.8	26.8	363.0
Net earned premiums	275.3	67.8	29.0	372.1
Underwriting result before expenses	168.6	32.9	13.2	214.7
Expenses				(180.1)
<b>Underwriting result</b>				<b>34.6</b>

\* Europe as disclosed above comprises Ireland, Netherlands, Germany and Spain. Business in other European countries is included under UK and Other.

## 2.6 Investment Performance

### 2.6.1 Investment Return

MIICL's business strategy recognises the importance of both consistent underwriting and operating profits and superior investment returns to build shareholder value. The Company relies on sound underwriting practices to produce investable funds while minimising underwriting risk. The majority of investable assets come from premiums paid by policyholders. Policyholder funds are invested in high-quality corporate and municipal bonds with relatively short durations. The balance, comprising shareholder funds, is available to be invested in equity securities, which, over the long run, have produced higher returns relative to fixed maturity investments. When purchasing equities, the Company seeks to invest in profitable companies, with honest and talented management that exhibit reinvestment opportunities and capital discipline at reasonable prices. The intention is to hold such investments over the long term.

Investment performance is measured by analysing net investment income, net realised investment gains and the movement in net unrealised gains on investments. The quality of the investment portfolio is not lowered in order to enhance or maintain yields. The Company focuses on long term total investment return, understanding that the level of realised and unrealised gains or losses may vary from one period to the next.

In accordance with FRS102, MIICL reports its bonds at amortised cost in its financial statements, whereas equities are recognised and measured at fair value through profit and loss. No investment gains or losses are recognised directly in equity.

SII requires investments to be measured at fair value. Set out below is a summary of the investment return for the year ended December 31, 2016 including market value movements on bonds. Investment returns are stated net of investment expenses of \$4.2m. Investment return percentages are based on income divided by the average of assets held.

	MV \$'000	Return \$'000	2016 %
Cash/Short Term	191,208	200	0.1%
Equities	169,428	20,614	12.5%
Bonds	935,529	35,858	3.7%
<b>Total investment return</b>	<b>1,296,165</b>	<b>56,672</b>	<b>4.2%</b>

Set out below is an analysis of the key drivers of the investment return.

	<b>2016</b>
	<b>\$'000</b>
Net investment income	31,784
Net realised gains and (losses)	16,211
Net unrealised gains and (losses)	8,677
<b>Total investment return</b>	<b>56,672</b>

The total investment return of 4.2% for the year ended December 31, 2016 reflected strong overall equity market performance.

### 2.6.2 SII Investment categorisation and disclosures

The Commission Implementing Regulation sets out required investment categorisation (these are discussed in more detail in section 5.2.4). SII also requires investments to be disclosed at their market value plus accrued interest. Set out below is a summary of the investment categorisations reported on the SII Balance Sheet (Appendix 1). No comparative is provided as that is prior to the start of the SII Directive.

	<b>SII</b>	<b>Accrued</b>	
	<b>Value</b>	<b>Interest</b>	<b>MV</b>
	<b>\$'000</b>	<b>\$'000</b>	<b>\$'000</b>
Equities	169,688	260	169,428
Government Bonds	526,905	5,684	521,221
Corporate Bonds	275,244	3,213	272,031
Collateralised Securities	177,700	430	177,270
Collective Investments Undertakings*	3,357	0	3,357
Deposits other than cash equivalents	4,795	1	4,794
Cash and cash equivalents	148,065	0	148,065
<b>Total</b>	<b>1,305,754</b>	<b>9,588</b>	<b>1,296,166</b>

\* investments in collective investment undertakings comprise Money Market Funds

### 2.6.3 Investment securitisation

As at December 31, 2016 the Company held \$177.7m in securitised assets, comprising:

- \$114.8m of Residential Mortgage Backed Securities ("RMBS") issued by US Government Sponsored Enterprises ("US GSEs") (Freddie Mac and Fannie Mae) and US Agencies (Ginnie Mae).
- \$56.3m of Commercial Mortgage Backed Securities ("CMBS") issued by Freddie Mac, Fannie Mae and Ginnie Mae.
- \$6.6m of CMBS from corporate issuers.

### 2.7 Performance of other activities

Not applicable.

### 2.8 Any other information

Not applicable.

## 3 System of Governance

### 3.1 General information on the system of governance

#### 3.1.1 The Board

The MIICL Board consists of 13 Board Directors, including 4 Non-Executive Directors one of whom is the Chairman of the Board.

The main purposes of the Board include:

- Ensure the Company has an effective and appropriate governance structure;
- Ensure the culture of Markel, as required by the 'Markel Style' and in Markel's 'Code of Conduct', is reflected in the activities of the Company at all levels and in all locations;
- Set the strategy and monitor the performance of the Company;
- Take reasonable care to maintain a clear and appropriate apportionment of significant responsibilities among its directors and senior managers in such a way that (1) it is clear who has which of those responsibilities and (2) the business and affairs of the firm can be adequately monitored and controlled by the Directors, relevant senior managers and governing body of the firm; &
- Meet the standards required for SII Firms by the PRA Handbook, including the 'Fundamental Rules', and the FCA handbook, including the 'Principles for Business'.

The President of MINT (Mr William Stovin) has responsibility for the apportionment of significant responsibilities to Directors and senior managers and for overseeing the establishment and maintenance of systems and controls appropriate to the business.

The Board has identified the officers who hold each relevant Senior Insurance Manager Function (details are held in the Financial Services Register) and has approved the allocation of PRA Prescribed Responsibilities.

#### 3.1.2 Board Reporting Committees

MIICL's governance arrangements include the following key committees:-

**Risk & Capital Committee** - The purpose of the Risk & Capital Committee is to assist the Board in its oversight of MIICL's Risk Management Strategy and Risk Management Framework, and the process by which the Company's solvency capital requirement is assessed and communicated to its regulator and other stakeholders. Its terms of reference include the following key duties:

- Approve the Enterprise-wide Risk Management ("ERM") framework established by management and monitor its effectiveness, on a continuous basis, on behalf of the Board.
- Ensure that the Risk Register and its components are maintained and updated.
- Oversee the governance and operation of the IM.
- Review and challenge the ORSA reports.
- Oversee and challenge the design and execution of an agreed set of stress and scenario tests.
- Consider emerging risks perceived to be potentially significant.

**Audit Committee** - The purpose of the Audit Committee is to assist the Board by overseeing the Internal Audit function and the relationship with the external auditors. Its terms of reference state that the Committee shall:

- Discuss the nature and scope of the annual external audit prior to work commencing and review the auditor's management letter and management's response.
- Review MIICL draft financial statements.
- Monitor, review and assess the effectiveness of the Internal Audit function in the context of MIICL's overall risk management system.
- Consider and approve the remit of the Internal Audit function, ensuring that it has adequate resources and appropriate access to information to enable it to perform its function effectively and in accordance with the relevant professional standards
- Ensure the Internal Audit function has adequate standing and is free from management or other restrictions.
- Receive and approve Internal Audit reports, including the findings and actions
- Consider and approve the annual Internal Audit Plan
- Review and approved changes to the Internal Audit Policy

**Reserving Committee** - The main purpose of the Reserving Committee is to assist the Board in their implementation of MIICL's Reserving Policy. Its remit includes:

- Review overall reserve movements as presented at the Combined Ratio Meetings ("CRM") and actions arising therefrom.
- Review the comparison of 'actuarial funds' to 'held funds' and agree closing held reserve position, including prudential margin as reported in the year-end financial statements.
- Review Technical Provisions.
- Review external reports and communications (SAO, reserving related regulatory communication and external actuarial reviews).

**Finance Committee** - The purpose of the Committee is to assist the Board in its review of certain MIICL financial and regulatory returns. The Committee is authorised by the Board to approve quarterly SII returns. The Committee is permitted to review the following, but they require full Board approval:

- MIICL Financial Statements.
- SFCR
- RSR

**Wholesale Board** – This is an operational board. Its main purpose is to consider and discuss matters impacting Wholesale underwriting and operations within the Marine, Energy & Property, Speciality & Financial Lines, Reinsurance and Global Insurance divisions and to make recommendations to the Board.

**National Markets Board** - This is an operational board. The main purpose of the National Markets Board is to consider and discuss matters which impact upon National Markets (i.e. non-Wholesale) and make recommendations to the Board.

**Remuneration Committee** - The main purpose of the Remuneration Committee is to ensure the remuneration structure (including bonuses), both for employees and Directors, is consistent with the Company's Remuneration Policy, UK regulations and good practice, and that they promote positive behaviour and a strong and appropriate conduct culture.

### 3.1.3 Key Functions

The Company has identified the roles which it considers to be a Key Function performed by a Key Function Holder. This includes people heading the Internal Audit, Risk, Compliance and Actuarial functions.

**Internal Audit** – The primary focus of the Head of Internal Audit is to manage the Internal Audit function so as to provide the Audit Committee and management with an independent assessment of the effectiveness and efficiency of risk management, control and governance processes within MIICL's business operations. The Internal Audit function may also assist management by performing other audit activities and participating, where required, in discussions on the design of internal controls, provided these other activities do not conflict with the primary focus.

**Compliance** – The main responsibility of the Compliance Officer is to enable the Company to meet and exceed the standards required by its regulators. His responsibilities include advising the Board on compliance with the laws, regulations and administrative provisions adopted pursuant to the SII Directive and other relevant regulatory requirements, to assess the possible impact of any significant changes in the legal environment on the operations of MIICL and the adequacy of the measures adopted to prevent non-compliance, and to deliver the annual Compliance Plan.

**Risk** – The main responsibilities of the Chief Risk Officer are to put in place and maintain effective Enterprise Risk Management comprising strategies, processes and reporting procedures necessary to identify, measure, monitor, manage and report, on a continuous basis the risks to which the Company is or could be exposed, and their interdependencies.

**Actuarial** – The main responsibility of the Chief Actuary, who is a Board Director, is to lead MIICL's Actuarial team and ensure that its stated objectives are met. His responsibilities include acting as Signing Actuary, all aspects relating to pricing, overseeing the actuarial contribution to capital (including Internal Model development, internal and regulatory reporting), overseeing all aspects of Catastrophe Modelling and

aggregation, and contributing to the effective implementation of the risk management of the business, including contributing to the ORSA.

#### 3.1.4 Remuneration policy and practices

##### **Principles**

MIICL's remuneration policy and practice is consistent with its business and risk strategy, risk profile, objectives, values, risk management practices, and long-term interests and performance and does not reward individuals for excessive risk taking.

Where there are country specific remuneration practices, they are consistent with laws and regulations applicable in those jurisdictions.

There is generally no fixed (guaranteed) element in bonus arrangements. In exceptional circumstances, primarily relating to recruitment, a bonus may be fixed (guaranteed) for a short period after joining to compensate for foregone bonus from prior employment.

Underwriting bonuses are paid by instalment over several years and are adjusted for actual experience. There are no golden parachutes.

Directors and employees have written Contracts of Employment and bonus rules are agreed and communicated on an annual basis.

The remuneration of certain Board directors is linked to the combined ratio of MINT and the underwriting bonuses are linked to relevant divisional underwriting performance. It is possible that the variable component of remuneration for certain Board directors and for underwriters may be greater in a year than their fixed component. For the other Board Directors and non-underwriting employees the variable component of their remuneration will be less than the fixed component of their overall remuneration, other than in very exceptional circumstances which would require exceptional performance at both MINT and Markel.

#### 3.1.5 Performance criteria

There are no stock options and bonuses are generally paid in cash. Restricted stock may be awarded to certain senior executives which vests with a 3 year cliff vesting period.

Bonuses are paid on a discretionary basis based upon specific performance objectives and/or Divisional, MINT and Markel's profitability as assessed independently by the Chief Actuary of the Company and the Chief Actuary of Markel.

**Directors** – Unless treated as an underwriter, bonuses of Executive Directors are aligned to MINT and Markel's business strategy, by a focus on MINT's profitability and Markel growth in book value. There is no fixed component to a Director's bonus. The remuneration of Non-Executive Directors does not include any bonus arrangement. Currently the bonus arrangement for one Executive Director, who is also a Divisional Managing Director, is the same as those which apply to underwriters.

**Underwriters** - Underwriter bonuses are aligned to Markel's business strategy, with an emphasis on sustainable underwriting profitability explicitly linked to annual combined ratio targets.

**Non-underwriting employees** - The remuneration package for non-underwriting employees includes a bonus potential expressed as a percentage of their annual salary which they can earn as a bonus for any calendar year. The majority of their bonus potential depends on the extent to which they fulfil their job role and goals, and how they display Markel competencies.

**Supplementary pension and early retirement schemes** - There are no supplementary pension schemes for Board members; Board members participate in the same pension schemes and in the same way as if they were an employee. Similarly, there are no early retirement schemes or arrangements for Board members which are not also available for employees, such as early retirement on grounds of ill-health.



### 3.1.6 Material transactions

During the reporting period, the Company declared and paid a dividend of USD 40,000,000 to its sole shareholder, MCH.

There were no other material transactions during the reporting period with the shareholder, with persons who exercise a significant influence on the undertaking, or with members of the Company's Board of Directors.

## 3.2 Fit and proper requirements

All Directors and all employees, whether or not they perform a key function, are recruited on the basis that their professional qualifications, knowledge, experience, management and/or technical competences and experience are adequate to enable sound and prudent management and that they are of good repute and integrity

### 3.2.1 Fit and Proper assessment

**At Recruitment** - A set of due diligence checks is performed at recruitment for everybody who comes on to MINT's payroll, and some additional checks are performed for people falling within the Company's definition of "high risk", which includes all Board Directors and Key Function Holders.

**Periodic Rechecking** - Relevant due diligence checks are re-performed on the third anniversary since the previous checks for Directors and other "high risk" employees.

**Reassessment** – In certain circumstances the Human Resources Director, in conjunction with the Head of Legal, Regulatory & Compliance, has authority to instigate a formal review and to investigate whether a Director or other Key Function Holder continues to meet the required standards to pass a Fit and Proper assessment.

**Annual confirmations** – Directors and other employees who perform either a PRA Senior Insurance Manager Function or a FCA Control Function are required to give an annual sign-off to the Legal, Regulatory & Compliance department on a number of matters. As part of this process they are asked to provide answers to Fitness & Propriety questions to check whether this has changed.

## 3.3 Risk management system including the Own Risk and Solvency Assessment

### 3.3.1 Risk Management

The Risk Management Function is responsible for ensuring the risks MIICL faces are assessed, mitigated and reported in accordance with our risk strategy and appetite.

Furthermore, in line with its responsibilities under SII, it is also responsible for all aspects of MIICL's IM, including the governance, design, implementation, testing, validation, and documentation of the IM. The Risk Management Function is also responsible for formulating the ORSA for Board approval.

### 3.3.2 ORSA

The ORSA is "the entirety of the processes and procedures employed to identify, assess, monitor, manage and report the short and long term risks MINT faces or may face, and to determine the own funds necessary to ensure that MINT's overall regulatory and economic capital requirements are met at all times."

An ORSA Report is produced at least annually to summarise these processes so that a suitably knowledgeable external reviewer would be able to gain an understanding of MIICL's risk and solvency assessment.

The report is owned by the Risk Management Function, with the Risk Management team responsible for co-ordinating its production. The report is agreed by the Board. The ORSA sets out the relationship between regulatory capital requirements and economic capital. Stress and scenario tests in the ORSA report test the risk profile against economic capital.

Economic capital is defined as the capital required to maintain MIICL's rating. It consists of:

- Capital at a 99.5% confidence level on a value at risk measure basis, on a "to ultimate" basis rather than the one year view; plus



- An uplift to support MIICL's rating.

Each quarter the Risk & Capital Committee ("R&CC") and the Board are presented with a brief assessment by Risk Management of risk and solvency. The Board may determine at any time that a formal reassessment is required and may determine the type and content of report that this reassessment should take.

### **3.4 Internal control system**

Across the Markel Group, management is responsible for establishing and maintaining adequate internal control over financial reporting, as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934. Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Management does not expect that its internal control over financial reporting will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met.

At MIICL, key controls over financial reporting have been identified and the owners of each control are asked to confirm that the control is in place and operating effectively. MIICL's Internal Audit tests these key controls annually and reports to the Audit Committee.

MIICL's internal controls system has been designed to provide assurance to the Board and senior management that standards are being adhered to and risks managed. This includes the reporting and review processes through which management can detect any variance from planned or expected outcomes.

The Company's internal controls cover all aspects of its business. Naturally, there are aspects to internal control in addition to those surrounding financial reporting. Alongside each major area of risk, the controls that are used to mitigate the risk are also identified and monitored. Risk controls can be tools or techniques to proactively identify, manage or reduce risk and may involve the policies, standards, procedures and operations of MIICL. The effectiveness of these controls is also managed at the local level. The MIICL risk register describes risk controls for each risk and identifies control ownership.

#### **3.4.1 Legal, Regulatory and Compliance Department**

The Company maintains a compliance function to advise the Board on compliance with laws, regulations and governance. Management and oversight responsibility for the Compliance Framework rests with MIICL's Legal, Regulatory and Compliance Department, which oversees and analyses changes in legislation and regulations and works with various departments to apply the Compliance Framework. The Compliance Framework is a continuous cycle of activities applicable to each area within MIICL under the direction and oversight of a compliance leader. As well as providing ad hoc briefings to management and associates with regard to regulatory and legislative changes and ad hoc advice upon request, the compliance function is proactive in implementing a communications strategy to ensure associates are aware of relevant issues. This includes electronic communication through the Company's Intranet and email, compliance forums and reviews of MIICL's approach to certain specific areas.

The Compliance Officer has access to the Board of MIICL and all sub-committees of the Board of MIICL and its subsidiaries, and to all its underwriting divisions and support departments.

### **3.5 Internal audit function**

Internal Audit is an independent, objective assurance and consulting function set up within MIICL as a service to the MIICL Board and executive management. Internal Audit assists MIICL achieve its objectives by bringing a systematic, disciplined approach to evaluate the effectiveness of risk management, control and governance processes. Internal Audit will make recommendations to management to improve the effectiveness of these processes.

Observations, findings, and recommendations, along with management's responses (where appropriate) are produced in the form of Internal Audit Reports, which are presented to the Audit Committee for approval. In addition, summaries of all work undertaken, key findings and an assessment of management's remediation plans, highlighting areas where there are significant delays, are presented to the Audit Committee each quarter.

At least annually Internal Audit provides an assessment of the overall effectiveness of the governance, and risk and control framework, together with an analysis of any themes emerging from Internal Audit work.

The internal audit function is implemented through a team of full time staff, supported by subject matter experts as required. To ensure the department's independence and objectivity, the Head of Internal Audit functionally reports to the Audit Committee and administratively reports to the Non-Executive Chairman of the Audit Committee.

### 3.6 Actuarial function

The role of the Actuarial Department is to analyse, investigate and explain the Company's technical liabilities to management, underwriters, various other departments and external parties.

MIICL's Actuarial Function carries out a number of tasks including the following:

- Coordinating the calculation of technical provisions, ensuring appropriate assumptions, methodologies and models are used;
- Informing the Board of the reliability and adequacy of the calculation of technical provisions
- Comparing best estimates against experience;
- Producing a report expressing an opinion on the overall underwriting policy, and another report on the adequacy of reinsurance arrangements; and
- Contributing to the risk-management system, in particular with respect to calculating the capital requirements for the Company.

### 3.7 Outsourcing

MIICL's Outsourcing Policy sets out its approach to meeting our regulatory requirements for outsourcing. The overall aim is to ensure that the Company is fully responsible for its obligations when it outsources. Outsourcing focuses on two key questions. First, what is outsourcing? Second, is that outsourcing critical or important to MIICL? The policy also details approval, oversight and contractual requirements for outsourcing.

#### 3.7.1 Critical / Important Outsourcing

A function or activity is to be viewed as 'critical' or 'important' if without it the Company could not deliver services to policyholders. Where a critical or important function or activity is outsourced an individual is appointed to have responsibility for monitoring and oversight of that function taking account of the nature of the arrangement. Areas where critical services are outsourced are listed below.

Outsourced function or activity	Jurisdiction
Processing services for most risks written	UK
Claims processing	UK
Delegated underwriting	Various
Claims handling and administration	Various
Catastrophe Management Data Cleansing	India
Payroll	UK
Data Centre /Data storage	UK

#### 3.7.2 Material Intra-Group Outsourcing

Certain functions are provided to the Company on an intra-group outsourced basis.

**Investment Management** - Markel Gayner Asset Management, a wholly owned subsidiary of Markel, has been appointed as the Company's investment manager. A written management agreement and investment management guidelines are in place. Investment management performance is monitored by the Finance Director and the Board.

**Treasury** - the bulk of the Company's treasury functions are performed by the corporate treasury team which is based in America. The Company's Finance Department and a small cash management function in London are regularly in contact with the US Treasury team and our Finance Director is responsible for oversight of these treasury services.

**Global Technical Services** - The Global Technology Services ("GTS") solutions are developed utilising industry standards and best practices. The data centre facilities utilise state-of-the-art, enterprise class infrastructure technologies to deliver optimal effective solutions. GTS has a diverse and dedicated staff of Information Technology ("IT") professionals who are proficient in systems architecture and integration. They work with customers to deliver secure and highly available solutions. GTS IT infrastructure consists of midrange platforms as well as virtualised network and storage infrastructure. The systems and applications managed by GTS are enterprise-wide in scope, mission critical, and essential for the operations of the Markel. The Services provided include: Platform services, Enterprise Service Desk, Access Control, Desktop Services, Global network Services, Communication Services, Database Administration and Global Security Services.

<b>Outsourced function or activity</b>	<b>Jurisdiction</b>
Investment Management	USA
Treasury functions	USA
Global Technical Services	USA

As stated above there is a separate written agreement for Investment Management, with other intra-group outsourcing governed by a written outsourcing agreement.

### **3.8 Assessment of adequacy of system of governance**

The Company's governance structure is established to:

- Ensure enterprise risk management is maintained at high standards;
- Ensure the business is operating in an efficient and effective manner; and
- Align control procedures for units within the organisation based on the risks they carry.

As MIICL continues to grow and develop over time, the Board reviews its governance systems to ensure that it remains appropriate for the nature, scale and complexity of risks to which MIICL is exposed.

MIICL and MSM commissioned an independent, external review of Board effectiveness in 2016. The review considered the effectiveness of the Board in respect of the UK Corporate Governance Code. Although the tenets of the Code are not compulsory for MIICL and MSM, as they are not listed in the UK, both the PRA and FCA consider the Code as best practice for the corporate governance arrangements of all authorised firms. The review also specifically assessed Markel against the Financial Reporting Council's ("FRC's") 'Guidance on Board Effectiveness' (published in March 2011).

In the review's opinion the MIICL and MSM Boards are working satisfactorily, with practices which are broadly in line with experience of similar sized firms in the Lloyd's and general insurance market. The operation of the Board is supported by an open culture, experienced Board members and a structured approach to governance matters.

### **3.9 Any other information**

Not applicable.

## 4 Risk Profile

### 4.1 Overview

Markel is committed to a structured and disciplined approach to risk management which considers strategy, process, people and technology. The aim of this approach is ensuring the perpetuation of the organisation by continually evaluating and managing risks to support achievement of our business objectives. As part of this commitment, Markel aims to maintain a positive and open culture towards risk management, throughout all levels of the organisation.

Markel considers the direction from Executive Management, or 'tone at the top', to be a critical element of its effective internal control and risk management programme. In particular, the ongoing involvement of the Board of Directors in performing its oversight function and Executive Management involvement in key aspects of the risk management framework forms the foundation for an effective 'risk aware' culture among associates, investors and other key stakeholders.

The risk management framework within Markel is purposefully linked to the values of the organisation through the 'Markel Style' vision. This includes the long-standing objectives of building the financial value of the organisation over the long term within an environment where its associates are able to challenge management.

### 4.2 Capital Requirements

The uses of the Company's risk management processes continue to evolve through a number of internal processes and reviews, linked to the development of risk and capital management throughout the Markel organisation.

Feedback loops are in place across MINT's governance committees and operational areas of the business to allow for continued improvements to the assessment process. The current and potential future uses of the risk and capital management tools, as part of integration into the decision making process include;

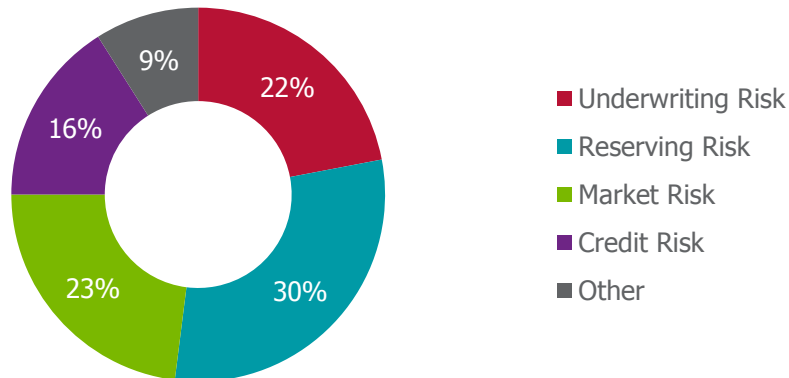
- Calculation of the capital requirements, subject to the necessary regulatory approvals.
- To provide useful information to senior and executive management in making ongoing business decisions.
- To be an integrated part of MINT's risk management framework and systems of governance.
- Assessment of risk exposure and capital requirements in the context of strategy expectations and planning.
- Reinsurance purchasing and reinsurer credit analysis.
- Reviewing risk appetite and tolerances.
- Other management decisions including the evaluation of new business opportunities.

On a regular basis, a mapping exercise between the risk framework and the risks included within the capital modelling process is undertaken. This process ensures that the capital model provides an assessment of MIICL's risk profile and that the risk framework continues to provide an appropriate representation of the risks faced by the business. The risk management processes are used to support parameterisation of inputs into the capital model across the risk categories with examples including underwriting inputs (also used as part of the Business Planning Process) and the creation of Operational Risk Scenarios across a range of frequencies and severity levels.

MIICL calculates the capital requirements for its specific risk profile using an Internal Model for which it received regulatory approval in December 2015.

As at 31 December 2016, the SCR risk profile for MIICL was as follows:

## 2016 One Year SCR



Insurance Risk, made up of Underwriting Risk and Reserving Risk, is the main contributor to MIICL's Risk Profile. "Other" comprises Operational Risk (6%) and Pension Risk (3%).

### 4.3 Risk Mitigation

The Company's Risk Register details the risks to which it is, or may be, exposed. For each risk there are a number of controls in place that are used to mitigate the risk and these are monitored over time. Risk controls can be tools or techniques to proactively identify, manage or reduce risk and may involve the policies, standards, procedures and operations of MIICL. The risk register describes risk controls for each risk and identifies control ownership. The controls include those that are key controls in relation to financial reporting in compliance with the Sarbanes Oxley Act, as well as those that are not regulatory requirements, but are key business controls.

Risk Management meet regularly with the Risk Owners individually and present information to them regarding the risk(s) that they own and facilitate discussion regarding risk exposure and the effectiveness of risk mitigation.

Information on each risk is presented quarterly to the R&CC, which consists of executive and non-executive Directors as well as other senior managers.

### 4.4 Stress & Sensitivity Tests

A range of sensitivity tests is conducted for MIICL, which allow for a better understanding of the key sensitivities for capital requirements.

MIICL carries out stress and scenario testing as part of the ORSA and Internal Model Validation processes. These tests include all the risk areas to which the Company has exposure. As part of its stress and scenario testing analysis, MIICL also sets out to identify and assess the explicit scenarios most likely to render its business model unviable, a process known as Reverse Stress Testing (RST). The process starts from an outcome of business failure of MIICL and identifies circumstances under which this might occur. In order for this to occur, MIICL would have to experience extremely remote natural catastrophe losses, severe reserve deteriorations, or a combination of various remote events.

In the context of this analysis, management concludes that the capital held by MIICL is more than adequate to meet solvency needs and maintain ratings at current levels with an acceptable degree of confidence. In addition, the capital and liquidity requirements that arise from a range of stress and scenario tests suggest that MIICL holds sufficient capital resources to achieve its business goals.

## 4.5 Key Risk areas

### 4.5.1 Underwriting Risk

Underwriting risk is defined as *"the risk of loss arising from the inherent uncertainties as to the occurrence, amount and timing of insurance liabilities, focusing on risks that arise from the acceptance of business."*

Underwriting Risk is divided into:

- Natural Catastrophe Risk;
- Non-natural Catastrophe Risk.

The Board of MIICL sets catastrophe risk limits in order to avoid excessive loss even in remote scenarios. The expectation is that remaining within these limits will allow MIICL to achieve its long-term underwriting target over the current five-year period.

MIICL aims to earn an underwriting profit over the long-term for all continuing product lines and will exit any product line that does not meet this expectation.

The Company measures underwriting risk against combined ratio and net loss ratio targets and the risk of aggregation against a series of risk appetite measures. MIICL's exposure to Natural Catastrophe Risk has decreased over the reporting period.

### 4.5.2 Reserving Risk

Reserving Risk is defined as *"the risk of loss arising from the inherent uncertainties as to the occurrence, amount and timing of insurance liabilities, focusing on risks that arise from the quantification of those liabilities."*

Examples of reserving risk mitigation techniques include case reserving and quarterly actuarial reserving exercises. Reserving Risk is measured by comparing held reserves against confidence level appetite. Each year an independent actuarial firm undertakes an analysis and assigns their own confidence level to MIICL's held reserves. Certain indicators are also reviewed to ensure that reserving is appropriate.

### 4.5.3 Market Risk

Market risk refers to *"the risk of loss resulting from adverse financial market movements including interest rates or exchange rates."*

MIICL assets are invested according to investment guidelines, reflecting MIICL's investment risk appetite. These investment guidelines define asset risk tolerances and limits, together with currency matching risk appetites.

Market Risk is measured by comparing asset concentration against investment guidelines.

MIICL is aware of the obligation to invest only in instruments with objectives of capital preservation and return on investment, in the best interest of its policyholders.

MIICL has established investment guidelines to ensure prudent investments and adequate liquidity to meet policyholder obligations. All investments are regularly monitored against these guidelines by the Board of MIICL.

MIICL's Investment Policy includes a number of key principles including a requirement that the Company adheres to the prudent person principle set out in article 132 of the Solvency II Directive.

### 4.5.4 Credit Risk

This Risk relates to *"the risk of loss arising from the inability of a counterparty to fulfil its payment obligations."* Credit Risk is divided into two areas, Reinsurance Credit Risk and the risk of non-payment of premium by brokers and coverholders.

Reinsurance is an integral part of the MINT business model, and therefore credit risk arises from reinsurance arrangements.

MIICL's appetite for exposure to reinsurers is based on security rating and capitalisation. Exposures are measured against these criteria and reinsurers may be requested to post collateral depending on their size, rating and potential debt to the Company.

Risk appetite is also monitored in terms of MIICL's exposure to brokers who may hold premium in relation to both inwards and outwards business.

#### 4.5.5 Operational Risk

Operational risk is *the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events.*" The Company recognises the importance of Operational Risk across all other risk areas: losses in other risk groups can be exacerbated by operational issues, for example poor data quality may affect Underwriting Risk. Therefore operational controls exist to mitigate each of these areas of risk, and these are factored into the parameterisation of these risk groups.

Through the application of controls MIICL seeks to avoid any material adverse event arising from Operational Risk. Examples of losses arising from Operational Risk include business disruption incidents, failure of IT systems or processes and internal fraud.

A number of metrics and benchmarks are used to monitor MIICL's operational risk profile, including the areas of business continuity, personnel and information technology & systems.

## 4.6 Other risk areas

### 4.6.1 Liquidity Risk

This area of risk relates to *"the risk that sufficient liquid financial resources are not maintained to meet liabilities as they fall due"*.

The aim is to maintain sufficient liquidity at MIICL to be able to meet payment obligations under severe catastrophe loss scenarios. Markel aims to support its liquidity position through the production of positive cashflow from operations.

Liquidity Risk is measured through stress testing. There have been no material changes in the Company's exposure to Liquidity Risk during the reporting period.

Expected profits in future premiums are \$43.8m as reported at in Appendix 7 (S.23.01.01, R0790, C0010)

### 4.6.2 Group Risk

This is *"the risk that actions or events within one part of the Markel Corporation adversely affect an entity, or all entities, within MINT"*. MIICL considers it a strength to be part of a larger, experienced insurance group, with considerable financial resources and sound reputation. A number of controls are in place; such as internal committees which consider the interests of MINT's legal entities and endeavour to communicate the MINT perspective to Markel, with whom MINT has an excellent relationship.

The risk of the Company being part of MINT is also considered. The policy is always to consider the interests of each legal entity, and our single risk strategy, risk management approach, operational procedures and standards are effective in ensuring that each entity is treated equitably. Overall the Board considers the fact that MIICL is part of a group that has insurance experience and significant capital resources assists in mitigating the risks to which MIICL is exposed.

### 4.6.3 Acquisition Risk

There is a desire to grow the business and look for potential acquisitions; however, these must be consistent with other strategic goals and risk strategy, and must complement existing operations. The Company's approach is to ensure effective identification, due diligence, valuation and integration leading to profitable acquisition activity.

Strategic decisions are discussed with Board members and then reported to the Board for approval. This will include significant or material strategic actions that may be taken by another Markel company but which impact either the operations or the management team of the Company. During the acquisition process, a due diligence checklist is applied, where appropriate, to validate business case assumptions and support the Board in its ultimate decision on whether to proceed formally. The due diligence checklist is primarily



focused on financial, legal and operational considerations and forms the basis for data room information requests. Post-acquisition, the checklist is leveraged to support the integration process into business as usual.

#### **4.6.4 Strategic Risk**

The Company is aware of the dangers of following an inappropriate strategy/our strategy not being adhered to throughout the organisation.

One of the strengths of being part of an insurance group is the benefit of the oversight of Markel, which is able to bring the collective insurance experience of many decades to ensuring that strategy is sound. The experience of the Company's non-executive Directors is also highly valued. Three of these have served on the boards of major insurance brokers and the fourth was formerly a partner at a major accountancy firm. They have therefore seen various strategies pursued by insurers, both successfully and unsuccessfully, and they can therefore challenge proposed strategies.

MIICL's IM provides additional perspective of potential changes to MIICL's risk profile and capital requirements as a result of possible changes in strategy.

#### **4.7 Any other information**

Not applicable.



## 5 Valuation for solvency purposes

### 5.1 General valuation principles required under SII Framework

MIICL's SII Balance Sheet as at December 31, 2016 is reported in QRT S.02.01.02, which is attached at Appendix 1.

In accordance with Article 75 of the SII Directive, assets and liabilities other than TPs have been measured in accordance with the principles of an arms-length transaction between knowledgeable, willing parties using market consistent valuation methods.

Section 5.1.1 below comprises a high level reconciliation from MIICL's UKGAAP Financial Statements to the SII Balance Sheet at Appendix 1. Sections 5.2 and 5.3 set out the valuation methodology for each material class of assets and liabilities, including a summary of the key valuation differences between the SII Balance Sheet and MIICL's Financial Statements, prepared on a UKGAAP basis.

#### 5.1.1 Comparison of UKGAAP Financial Statements and SII Balance Sheet

Balance Sheet Item	SFCR Ref	UKGAAP FS \$'000	Reclass Adj \$'000	SII Val Adj \$'000	SII \$'000
Investments in related undertakings	5.2.2	5,939			5,939
Equities	5.2.3	169,727	(39)	█	169,688
Bonds	5.2.4	884,033	44,619	51,197	979,849
Collective Investment Undertakings	5.2.5	3,357			3,357
Short term investments	5.2.4	34,993	(34,993)		0
Deposits other than cash and cash equivalents	5.2.6	0	4,795	█	4,795
Reinsurance recoverable from non-life TPs	5.2.7	557,187		(103,423)	453,764
Reinsurers' share of unearned premiums	5.2.12	38,237		(38,237)	0
Deferred acquisition costs	5.2.12	35,827		(35,827)	0
Insurance and intermediaries receivables	5.2.9	67,823	(43,568)	█	24,255
Reinsurance receivables	5.2.9	100,541	(44,069)		56,472
Receivables (trade not insurance)	5.2.10	12,523		█	12,523
Cash and cash equivalents	5.2.11	152,858	(4,793)		148,065
Accrued interest	5.2.3/5.2.4	9,589	(9,589)	█	0
Fixed assets	5.2.1	74			74
Deposits with ceding undertakings	5.2.8	5,229			5,229
<b>Total Assets</b>		<b>2,077,937</b>	<b>(87,637)</b>	<b>(126,290)</b>	<b>1,864,010</b>
Best Estimate TPs - non-life	5.3.3	1,192,447	(72,947)	(110,202)	1,009,298
Best Estimate TPs - life	5.3.3	0		22,353	22,353
Risk Margin (unaudited)	5.3.3	0		85,422	85,422
Gross unearned premiums	5.4.6	186,451		(186,451)	0
Pension benefit obligations	5.4.1	2,438			2,438
Deposits from reinsurers	5.4.2		14,708	█	14,708
Deferred tax liabilities	5.4.3	1,438		11,270	12,708
Insurance and intermediaries payables	5.4.4	9,446		█	9,446
Reinsurance payables	5.4.4	30,295	(14,690)		15,605
Payables (trade not insurance)	5.4.5	36,711	(14,708)		22,003
<b>Total Liabilities</b>		<b>1,459,226</b>	<b>(87,637)</b>	<b>(177,608)</b>	<b>1,193,981</b>
<b>Excess of Assets over Liabilities</b>		<b>618,711</b>	<b>0</b>	<b>51,318</b>	<b>670,029</b>

## 5.2 Assets

### 5.2.1 Property, Plant and Equipment

As at December 31, 2016 MIICL held \$0.1m of fixed assets. These were valued at replacement cost in accordance with Article 10.7(c) of the Delegated Regulation. This approximated to the net book value as reported in MIICL's UKGAAP Financial Statements.

### 5.2.2 Holdings in Related Undertakings

MIICL's subsidiaries as at December 31, 2016 were MSM, MISL and MEL.

Under Article 13.1(b) of the Delegated Regulation, investments in subsidiaries must be valued using the "adjusted equity method" where there is no quoted market price available. MIICL's investment in subsidiaries has been valued using the adjusted equity method. Effectively, this requires the underlying assets and liabilities within each subsidiary to be valued in accordance with SII and for MIICL to value its investment based on its share of its subsidiaries' net assets on a SII basis.

MIICL reports its investment in subsidiaries at the lower of cost and net realisable value in its Financial Statements.

Although different valuation bases were used for MIICL's SII Balance Sheet and its UKGAAP Financial Statements, the value as at December 31, 2016 was \$5.9m under both bases.

### 5.2.3 Equities

Excluding its investment in subsidiaries, MIICL's equity portfolio comprises securities listed on recognised stock exchanges (primarily the New York Stock Exchange). Equities were stated at fair value under SII, based on market prices at the reporting date. As these are publicly traded securities, the market prices are readily available and are actively traded. MIICL applies International Accounting Standard ("IAS39") Financial Instruments: Recognition and Measurement in reporting its equities in its Financial Statements. In accordance with IAS39, MIICL's equities are reported at market value in its Financial Statements, so the valuation is the same as under SII.

SII requires accrued income to be disclosed as part of the overall value of investments compared to UKGAAP where accrued income is disclosed separately. Accordingly, for SII purposes, accrued income is reclassified to the appropriate investment categories as shown in the reconciliation table in section 5.1.1.

MIICL's equities were valued at \$169.7m in its SII Balance Sheet (Appendix 1, R0100, C0010). The value in MIICL's Financial Statements was also \$169.7m, but the Financial Statement disclosure included variable interest rate bonds of \$0.3m, which were disclosed within bonds for SII purposes and this difference was offset by the fact that the SII value of equities included \$0.3m of accrued dividends.

### 5.2.4 Bonds

MIICL's bonds are stated at amortised cost in its UKGAAP Financial Statements in accordance with Chapter 11 of FRS102.

MIICL's bonds are reported at fair value under SII, based on market prices at the reporting date. Investments reported at market value fall onto one of three levels of fair value hierarchy as follows:

- **Level 1** financial assets are those which are measured by reference to published quotes in an active market. A financial instrument is regarded as quoted in an active market if quoted prices are readily 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.
- **Level 2** financial assets are those which are measured using a valuation technique based on assumptions that are supported by prices from observable current market transactions. For example, assets for which prices have not been determined in an active market, financial assets with fair values based on broker quotes, investments in private equity funds with fair values obtained via fund managers and assets that are valued using the Company's own models whereby the significant inputs into the assumptions are market observable.
- **Level 3** financial assets represent those which are measured using a valuation technique (model) based on assumptions that are neither supported by prices from observable current market transactions in the same instrument, nor are they based on available market data. Therefore,

significant unobservable inputs reflect the Company's own assumptions about the assumptions market participants would use in pricing the asset or liability (including assumptions about risk). These inputs are developed based on the best information available, which might include the Company's own data.

MIICL's bonds were valued at \$979.8m in its SII Balance Sheet (Appendix 1, R0130, C0010), including accrued income of \$9.3m compared to \$919.0m in its Financial Statements (including investments in short term debt securities). MIICL bonds are categorised as level 2.

In accordance SII requirements, bonds have been categorised between Government Bonds, Corporate Bonds and Collateralised Securities. The categorisations differ from presentation in the Financial Statements. SII classifications are:

- **Government Bonds.** The criteria for recognition as government bonds is set out in the Delegated Regulation and represent bonds issued by central governments, supranational government institutions, regional governments or local authorities. Notably it excludes most government guaranteed bonds.
- **Collateralised Securities** are securities whose value and payments are derived from a portfolio of underlying assets. Includes Asset Backed Securities ("ABS"), Mortgage Backed securities ("MBS"), Commercial Mortgage Backed securities ("CMBS"), Collateralised Debt Obligations ("CDO"), Collateralised Loan Obligations ("CLO") and Collateralised Mortgage Obligations ("CMO").
- **Corporate Bonds** represent bonds issued by corporations and bonds that are not eligible for classification under other categories (for example government guarantee bonds).

As at December 31, 2016, MIICL held:

- Government Bonds of \$526.9m (Appendix 1, R0140, C0010).
- Corporate Bonds of \$275.2m (Appendix 1, R0150, C0010).
- Collateralised Securities of \$177.7m (Appendix 1, R0170, C0010). MIICL's Collateralised Securities consisted of CMO, MBS and CMBS securities. It did not hold any CDO or CLO securities.

#### 5.2.5 Collective Investment Undertakings

As at December 31, 2016, MIICL held \$3.4m in collective investment undertakings (Appendix 1, R0180, C0010). This comprises its investment in Money Market Funds. These investments are classified as cash and cash equivalents in its Financial Statements and were valued at cost. This represents the net realisable cash value, and is the alternative valuation method permitted under SII.

#### 5.2.6 Deposits other than Cash Equivalents

MIICL held \$4.8m in deposits other than cash equivalents (Appendix 1, R0200, C0010), which represent cash deposits with original maturities of more than three months. This represents the net realisable cash value, and is the alternative valuation method permitted under SII. The impact of time value of money is immaterial to the valuation.

#### 5.2.7 Reinsurance Recoverables

MIICL reported reinsurance recoverables of \$453.8m as at December 31, 2016 (Appendix 1, R0270, C0010), being the reinsurers' share of technical provisions valued on a SII basis. The SII valuation methodology is discussed in more detail in section 5.3 below. The impact of time value of money is immaterial to the valuation.

#### 5.2.8 Deposits to Cedants

Deposits with ceding undertakings of \$5.2m were valued at cost in MIICL's Financial Statements. This represents the net realisable cash value, and is the alternative valuation method permitted under SII. The impact of time value of money is immaterial to the valuation.

#### 5.2.9 Insurance and Reinsurance Receivables

MIICL reported debtors of \$67.8m and \$100.5m arising out of insurance and reinsurance operations respectively in its Financial Statements.

Debtors as reported in the Financial Statements comprise premiums receivable, reinsurance recoveries on paid claims, gross accrued premiums and claims float balances. They are measured at initial recognition value less any provision for bad debt on reinsurance recoveries on paid claims.

Gross accrued premiums constitute future premium cashflows under SII and as such form part of SII TPs. Accordingly, \$87.5m of gross accrued premium (comprising \$43.5m in respect of direct and \$44.0m in respect of reinsurance operations) was reclassified to SII TPs. The remaining debtor balances of \$24.3m of insurance receivables and \$56.5m of reinsurance receivables represent the net realisable value of these debtors and is the alternative valuation method permitted under SII.

#### **5.2.10 Trade Receivables**

Trade receivables of \$12.5m primarily consist of intercompany balances due from subsidiaries. They are measured at initial recognition value in the Financial Statements and, as these represent the net realisable cash value this is the alternative valuation method permitted under SII.

#### **5.2.11 Cash and Cash Equivalents**

Cash and cash equivalents of \$148.1m represent cash deposits with original maturities of less than three months. They are stated at the realisable cash value of the assets in accordance with SII.

#### **5.2.12 Deferred Acquisition Costs and Reinsurers' Share of Unearned Premiums**

Deferred acquisition costs and reinsurers' share of unearned premiums are assets which are recognised in MIIICL's Financial Statements. However, these assets are not recognised under SII due to the valuation basis required for Technical Provisions. Accordingly, these assets are valued at nil for SII.

### **5.3 Technical Provisions**

#### **5.3.1 Required Valuation Methodology under SII Framework**

Article 76 of the SII Directive defines the value of SII TPs as the "current amount insurance and reinsurance undertakings would have to pay if they were to transfer their insurance and reinsurance obligations immediately to another insurance or reinsurance undertaking".

Article 77 defines this as the sum of a "Best Estimate Provision" and a "Risk Margin".

#### **Best Estimate Provision**

The Best Estimate Provision is further clarified as:

"the probability weighted average of future cashflows, taking account of the time value of money (expected value of future cashflows) using the relevant risk free interest rate term structure. The cashflow projection used in the calculation of the best estimate shall be based upon up to date and credible information and realistic assumptions and be performed using adequate, applicable and relevant actuarial and statistical methods.

The cashflow projection used in the calculation of the best estimate shall take account of all the cash inflows and outflows required to settle the insurance and reinsurance obligations over the lifetime thereof.

The best estimate shall be calculated gross, without deduction of the amounts recoverable from reinsurance contracts and special purpose vehicles. These amounts shall be calculated separately, in accordance with Article 81." (Article 77.2 SII Directive).

#### **Risk Margin**

The risk margin is intended to represent the premium over the Best Estimate TPs that insurance or reinsurance undertakings would require in order to assume liability for the TPs transferred.

Under Article 77.5 of the SII Directive it is defined as "the provision calculated by determining the cost of providing an amount of eligible own funds to the Solvency Capital Requirement necessary to support the insurance and reinsurance obligations over the lifetime thereof. The rate used in the determination of the cost of providing that amount of eligible own funds (Cost of Capital rate) shall be the same for all insurance and reinsurance undertakings and shall be reviewed periodically."

The key implications of the above requirements are:

- Technical provisions are valued at their best estimate (mean of the full range of possible outcomes). Accordingly, any explicit or implicit margins over the best estimate should be excluded.
- The full range of possible future outcomes should include low probability extreme events, including latent claims ("Events Not In Data").
- Technical provision valuations include future premium cash inflows and outflows. Under UKGAAP, future premiums are reflected as accrued premiums within insurance debtors and creditors.
- The change to a cashflow basis compared to earning basis of recognition of technical provisions removes the requirement for the non-monetary items under UKGAAP of Deferred Acquisition Costs ("DAC") and Unearned Premium Reserves ("UPR").
- The cashflow projections are required to take account of all expenses incurred in servicing the insurance obligations, which introduces the requirement to recognise additional expense provisions as part of overall technical provisions.
- The introduction of discounting represents a major change from current reporting bases. Under SII valuation requirements, future TP cashflows are discounted to their net present value using risk free rate yield curves prescribed EIOPA.
- The risk margin replaces existing explicit or implicit margins over best estimate provisions and is required to be calculated using a standardised approach.
- In addition, SII requires contracts to be recognised on a legal obligation basis as opposed to an inception date basis. Accordingly, technical provisions recognised at the December year end may include values for business not incepting until January or later the following year. Under the legal obligation basis, SII recognises that firms will have already committed to a contract in advance of the inception date.

### 5.3.2 Uncertainties with valuations of technical provisions

The adequacy of the Best Estimate TPs is assessed by reference to projections of the ultimate development of claims in respect of each underwriting year. Management continually attempts to improve its loss estimation process by refining its ability to analyse loss development patterns, claims payments and other information, but many reasons remain for potential adverse development of estimated ultimate liabilities.

The process of estimating loss reserves is a difficult and complex exercise involving many variables and subjective judgements. As part of the reserving process, the Company reviews historical data and considers the impact of various factors such as trends in claim frequency and severity, changes in operations, emerging economic and social trends, inflation and changes in regulatory and litigation environments. Significant delays occur in notifying certain claims and a large measure of experience and judgement is involved in assessing outstanding liabilities, the ultimate cost of which cannot be known with certainty at the reporting date. The Best Estimate TPs are determined on the basis of information currently available. However, it is inherent in the nature of the business written that the ultimate liabilities may vary as a result of subsequent development. The two most critical assumptions as regards these claims provisions are that the past is a reasonable predictor of the likely level of claims development and that the models used for current business are fair reflections of the likely level of ultimate claims to be incurred. However, the Company believes the process of evaluating past experience, adjusted for the effects of current developments and anticipated trends, is an appropriate basis for predicting future events. There is no precise method, however, for evaluating the impact of any significant factor on the adequacy of reserves, and actual results are likely to differ from original estimates. Management has considered environmental and latent injury claims and claims expenses in establishing the Company's reserve for unpaid losses and loss adjustment expenses. The Company continues to be advised of claims asserting injuries from hazardous materials and alleged damages to cover various clean-up costs affecting policies written in prior years. Coverage and claim settlement issues, such as determining that coverage exists and defining an occurrence, may cause the actual loss development to show more variation than the rest of the Company's book of business. Traditional reserving techniques cannot be used to estimate asbestos-related and environmental pollution claims and so the uncertainty about the ultimate cost of these types of claims is greater than the

uncertainty relating to standard lines of business. The Company believes it has made reasonable provisions for claims, although the ultimate liability may be more or less than held reserves. The Company believes that future losses associated with these claims will not have a material adverse effect on its financial position. Still, there is no assurance that such losses will not materially affect the Company's results of operations for any period. Management is not able to estimate the additional loss, or range of loss, that is reasonably possible.

### 5.3.3 Value of Technical Provisions as at December 31, 2016 and analysis by line of business

MIICL's SII TPs were valued at \$663.3m as at December 31, 2016 comprising Best Estimate TPs of \$577.9m plus a Risk Margin of \$85.4m (unaudited).

Net Best Estimate TPs comprise \$555.5m (Gross \$1,009.3m) in respect of Non-Life TPs, which are analysed by line of business on QRT S.17.01.02 (Appendix 4) and Life TPs of \$22.4m (Gross \$22.4m) which are analysed on QRT S.12.01.02 (Appendix 5). The Life TPs relate to potential Non-Life Annuities Motor Periodic Payment Order Claims.

### 5.3.4 Transitional Provisions

The Company has not applied any of the following transitional provisions or adjustments:

- matching adjustment referred to in Article 77b of Directive 2009/138/EC
- volatility adjustment referred to in Article 77d of Directive 2009/138/EC
- the transitional risk-free interest rate-term structure referred to Article 308c of Directive 2009/138/EC
- the transitional deduction referred to in Article 308d of Directive 2009/138/EC

## 5.4 Other liabilities

### 5.4.1 Pension Benefit Obligations

As set out in MIICL's Financial Statements, the Company contributes to a pension scheme ("Terra Nova Life and Pension Scheme") which provides benefits based on final pensionable salary. On November 11, 2008 an agreement was signed resulting in a bulk transfer of assets and liabilities from the Lloyd's Superannuation Fund ("LSF") into the Terra Nova Life and Pension Scheme. With effect from that date the scheme was divided into 2 legally separate sections: the "TN Fund" and the "LSF Fund". On April 1, 2012, the Company closed the Scheme for future service accrual.

An independent actuarial valuation of both the TN Fund and the LSF Fund was carried out as at December 31, 2016 using the projected unit method. This resulted in a deficit in the Scheme of \$2.4m as at December 31, 2016. In accordance with FRS102, the Company recognised this in full in its Financial Statements for the year then ended.

In accordance with Article 9 of the Delegated Regulation, International Accounting Standard 19: Employee Benefits ("IAS19") was followed in order to value the Company's Pension Benefit Obligations for SII purpose. The value under this basis is the same as recognised in the Company's Financial Statements.

### 5.4.2 Deposits from Reinsurers

Deposits from reinsurers were valued at cost in MIICL's Financial Statements. This equates to the net amount at which these liabilities are expected to be settled and, accordingly, the fair value under SII is the same.

### 5.4.3 Deferred Tax Liabilities

## Financial Statements

MIICL reported a deferred tax liability of \$1.4m in its Financial Statements. This was valued as follows:

- Deferred tax is provided on timing differences which 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.
- The following timing differences are not provided for:



- a) differences between accumulated depreciation and tax allowances for the cost of a fixed asset if and when all conditions for retaining the tax allowances have been met;
  - b) differences relating to investments in subsidiaries, to the extent that it is not probable that they will reverse in the foreseeable future and the reporting entity is able to control the reversal of the timing difference;
  - c) deferred tax is not recognised on permanent differences arising because certain types of income or expense are non-taxable or are disallowable for tax or because certain tax charges or allowances are greater or smaller than the corresponding income or expense.
- Deferred tax is measured at the tax rate that is expected to apply to the reversal of the related difference, using tax rates enacted or substantively enacted at the reporting date. Deferred tax balances are not discounted.
  - Unrelieved tax losses and other deferred tax assets are recognised only to the extent that it is probable that they will be recovered against the reversal of deferred tax liabilities or other future taxable profits.

### **Solvency II Valuation**

Article 15 of the Delegated Regulation states that, firms should “recognise and value deferred taxes in relation to all assets and liabilities, including technical provisions that are recognised under the SII framework”.

The provision for deferred tax in MIICL’s SII Balance Sheet was valued as follows:

- The deferred tax liability in the Financial Statements was adjusted for the provision of deferred tax on differences between the valuation of assets and liabilities in the Financial Statements and the SII Balance Sheet.
- The additional deferred tax was measured at the tax rate applicable as at December 31, 2016.

#### **5.4.4 Insurance and Reinsurance Payables**

Creditors arising out of insurance and reinsurance operations as reported in the Financial Statements comprise claims payable, reinsurance premiums payable, accrued reinsurance premiums. They are measured at initial recognition value.

Accrued Reinsurance Premiums constitute future premium cashflows under SII and as such are reclassified to Technical Provisions. The remaining creditor balances of \$9.4m insurance payables and \$15.6m reinsurance payables represent the net amount expected to be settled and therefore represents the fair value under a SII basis.

#### **5.4.5 Trade Payables**

Trade payables have been measured at initial recognition value in the Financial Statements and, as these represent the amount at which they are expected to be settled, no adjustment has been made to reflect these at fair value under SII.

#### **5.4.6 Gross Unearned Premiums**

The provision for gross unearned premiums is a liability recognised in MIICL’s Financial Statements. However, this is not a liability which is recognised under SII due to the valuation basis required for Technical Provisions. Accordingly, it is valued at nil for SII.

### **5.5 Alternative methods for valuation**

The Company has applied alternative valuation methods for the following assets and liabilities:

- Insurance and reinsurance receivables (stated at net realisable value)
- Trade receivables (stated at net realisable value)
- Cash and cash equivalents (stated at net realisable value)
- Deposits with ceding undertakings
- Trade payables
- Deposits from reinsurers

## **5.6 Any other information**

Not applicable.



## 6 Capital Management

### 6.1 Own Funds

#### 6.1.1 Objectives, policies and processes for managing own funds

The Company's available own funds, eligible own funds and ratio of eligible own funds over SCR and MCR are disclosed in QRT S.23.01.01 (Appendix 7).

The objective of the business is to maintain sufficient own funds to cover the SCR, MCR and Economic Capital (based on the uSCR) with an appropriate buffer. Own funds should be of sufficient quality to meet the eligibility requirements in Article 82 of the Delegated Regulation.

The Company holds regular meetings of senior management, which are at least quarterly, at which the ratio of eligible own funds over SCR and MCR are reviewed. These committees are discussed in more detail in section 3.1 on the governance processes.

As discussed in section 3.3.2, the Company prepares an ORSA report on at least an annual basis, which contains a five year projection of economic capital and own funds.

There were no material changes in the objectives, policies or processes during the reporting period.

#### 6.1.2 Own Funds classified by Tiers

All of the Company's own funds qualify as Tier 1, unrestricted capital. The components are:

##### Ordinary Share Capital

There was \$267.2m called up, issued and fully paid ordinary share capital as at December 31, 2016. This is a high quality, available own fund item that has been classified as Tier 1 on the basis that it is an eligible Tier 1 item under Article 69 and meets the criteria set out under Article 71 of the Delegated Regulation.

##### Share Premium

There was \$199.8m share premium as at December 31, 2016. This is a high quality, available own fund item that has been classified as Tier 1 on the basis that it is an eligible Tier 1 item under Article 69 and meets the criteria set out under Article 71 of the Delegated Regulation.

##### Reconciliation Reserve

The reconciliation reserve was \$203.0m as at December 31, 2016, comprising SII net assets of \$670.0m (excess of assets over liabilities), less other basic own fund items of \$467.0m. It has been classified as Tier 1 on the basis that it is an eligible Tier 1 item under Article 69 and meets the criteria set out under Article 71 of the Delegated Regulation.

There were no foreseeable dividends and no own shares held.

#### 6.1.3 Transitional Arrangements

The Company does not hold any own fund items subject to transitional arrangements under Articles 308b(9) and 308b(10) of the Delegated Regulation and the Company does not hold any ancillary own funds.

#### 6.1.4 Difference between Shareholder's Equity as shown in the Financial Statements and the SII value of excess assets over liabilities

Shareholders' equity of \$618.7m was reported in the Financial Statements as at December 31, 2016, whilst the SII value of excess assets over liabilities was \$670.0m (S.02.01.02.R1000.C0010) (Appendix 1).

A reconciliation of the key valuation differences is set out in section 5.1.1.

#### 6.1.5 Eligible amount of Own Funds to meet SCR

All of the Company's own funds are Tier 1 and are unrestricted in terms of eligibility for meeting the SCR.

Total eligible own funds were \$670.0m. The coverage over SCR was 207.3%.

#### 6.1.6 Eligible amount of Own Funds to meet MCR

Total eligible own funds were \$670.0m. The coverage over MCR was 616.1%.

## 6.2 Solvency Capital Requirement and Minimum Capital Requirement

### 6.2.1 Internal Model SCR

The SCR is the amount of funds that the Company is required to hold in line with the SII Directive. The SCR can be calculated using the Standard Formula or an IM.

In accordance with Article 100 of the SII Directive, the SCR corresponds to the "Value-at-Risk of basic own funds of an insurance or reinsurance undertaking, subject to a confidence level of 99.5% over a one year time period." ("One Year SCR").

The SCR is to be calculated on the assumption that the undertaking will pursue its business as a going concern and shall cover existing business as well as business to be written over the next 12 months.

The scope of MIICL's IM is defined as:

- Market International Capital Engine ("MICE"), which forms the "calculation kernel" of the IM
- External models (ESG and RMS)
- Data inputs

Data inputs include the business plan, underwriting and reserving data, investments, Balance Sheets, credit risk and operational risk data.

On December 5, 2015 the PRA granted MIICL approval to use a full internal model to calculate its capital requirements and this approval was effective from the start of the SII Directive on January 1, 2016.

Set out below is the One Year IM SCR as at December 31, 2016 in line with the key risk categories discussed in section 4.5.

No comparative to 2015 is provided as that was prior to the start of the SII Directive. However, changes in data and parameters resulted in an increase of more than 10% in the SCR, thereby constituting a "major model change" under PRA requirements. An application for approval of the major model change was submitted to the PRA and was approved in November 2016.

	2016 \$'m	%
Reserve Risk	183.1	30%
Underwriting Risk	141.9	22%
Market Risk	143.7	23%
Operational Risk	38.2	6%
Credit Risk	104.2	16%
Pension Risk	22.0	3%
<b>Total Undiversified components</b>	<b>633.1</b>	<b>101%</b>
Diversification	(309.9)	
<b>Total SCR</b>	<b>323.2</b>	

- Reserve risk represents the largest risk category and captures the risk of adverse development in existing (earned) business.
- Underwriting risk captures the risk relating to business to be written over the following 12 months or business unearned at the model start date. The parameterisation of Underwriting Risk looks at the Attritional, Large Loss and Catastrophe Losses for each class of business. The parameterisation of the model determines the expected loss ratio and sets an associated volatility for each of these risk categories within each business class.
- Market Risk includes equity risk, interest rate risk, spread risk and foreign exchange risk. Data inputs include the investment portfolio and economic data parameters modelled by the ESG.
- Operational risk uses an Event Loss table to generate the frequency and severity of losses.
- Credit risk captures counterparty and reinsurer default risk.

- Pension risk relates to MIICL's defined pension scheme, which was closed to future service accruals with effect from April 1, 2012. Pension risk is not modelled within MICE, but is generated as a separate addition to the IM SCR from capital stress tests on pension scheme assets and liabilities.

### 6.2.2 Minimum Capital Requirement

The Company uses the Standard Formula to calculate the MCR. Inputs comprise the net best estimate SII TPs split by SII Lob, together with net written premiums for the previous 12 months split by SII lob. Net written premiums are on a SII basis and include movements on unincurred premiums.

A detailed calculation of the MCR is included in QRT S.28.01.01 at Appendix 8. Set out below is a summary of the MCR calculation.

	<b>2016</b>
	<b>\$'m</b>
Linear MCR	108.7
SCR	323.2
MCR cap	145.4
MCR floor	80.8
Combined MCR	108.7
Absolute floor	4.1
<b>Minimum Capital Requirement</b>	<b>108.7</b>

The linear MCR of \$108.7m represents the MCR calculated by applying standard formula factors to the net best estimate TPs and net written premiums on a SII basis, split by SII Lob. The linear MCR is then subject to a cap of 45% (\$145.4m) and a floor of 25% (\$80.8m) of the One Year SCR. The absolute floor of \$4.1m is based on the absolute floor of €3.7m.

As the linear MCR of \$108.7m exceeds the MCR floor, but is lower than the MCR cap, it is the formal MCR as at December 31, 2016.

### 6.2.3 Underwriting specific parameters pursuant to Article 104 of the SII Directive

Not applicable as MIICL calculates its SCR using a full IM.

### 6.2.4 Application of options under Article 51 of the SII Directive

Not applicable.

## 6.3 Use of duration based equity risk sub-module in the calculation of the Solvency Capital Requirement

Not applicable.

## 6.4 Differences between the Standard Formula and the IM

### 6.4.1 Uses of IM

MIICL has a number of areas which it has identified for potential IM. These include, but are not limited to:

- Capital Assessments (including SCR, uSCR and as a basis for the assessment of Economic Capital)
- Allocation of capital (at least to Risk groups and Underwriting and Reserving Risk to Divisions)
- Business planning
- Risk Appetite Monitoring and Consumption
- Reinsurance programme design
- Acquisitions and new classes of business
- Output for the ORSA and other Risk Management Analysis

The IM will be used for other areas where it is sensible to do so. There may also be exceptions where it is not reasonable or relevant to use the IM, for example, where there is insufficient data to employ stochastic modelling.

#### 6.4.2 Data for the IMI

Data within the IM is defined as including:

- structured information which has been captured in a codified context, such as data held in defined fields on systems;
- expert judgment (for example in setting coefficients of variation); and
- Data sets – final aggregations of data for specific purposes such as reserving, catastrophe modelling for use within the IM.

It is ensured that the data used in the IM is appropriate through a number of measures. This includes, but is not limited to:

- the formulation of a Data Directory that sets out the source, characteristics and usage of data within our model; and
- a Data Policy, approved by the Board, and sign off by Data owners that the data sets they have provided are materially complete, accurate, and appropriate prior to the approval of capital assessments by the Board.

#### 6.4.3 Internal Model SCR – methodology and time horizon

The IM models risk over a one year time horizon, consistent with the requirements set out in section 6.2.1, but also models risks arising on a longer time horizon (“risk to ultimate basis”). The SCR modelled under this latter approach forms the uSCR, and is the basis for the Company’s Economic Capital assessments.

The IM is a stochastic simulation model. It calculates the cashflows that would arise from the risks included and over both a one year and risk to ultimate time horizon and combines these to provide a view of MIICL’s financial position at different levels of probability. Consistent with the requirements of the SII Directive, the value at the 99.5 percentile for risks emerging over a one year time horizon forms the One Year SCR.

#### 6.4.4 Key differences in methodologies between the IM and SF

Both the IM and SF cover the material risks to which MIICL is exposed, but the Company applied to use a full IM on the basis that it more appropriately reflected MIICL’s risk profile. Key differences between the SF and IM SCR methodologies are set out below:

- Catastrophe Risk under the SF is largely based on percentage loads (250% for assumed and 175% for direct business) to premiums as opposed to scenario analyses (this is particularly true for US, South America and Asian Cat exposures). The IM SCR is based on actual exposures and modelled scenarios from an Event Loss Table by region and perils, allowing for the reinsurance programme to be applied for each of these catastrophe losses.
- Premium and Reserve Risk is calculated in aggregate under the SF, applying market average load factors to Premium and Reserve volumes categorized by Solvency II Lob. The IM considers Premium and Reserve Risk separately and at a more granular class level, better reflecting MIICL’s risk profile and loss experience. For example, under the SF, third party liability is a large single class whereas in the Internal Model this comprises several classes of business with varying risk profiles.
- Counterparty Credit Risk from the IM tends to be higher than the risk calculated by the SF and is mostly driven by credit risk on reinsurer default. The SF applies standard load factors to the best estimate reinsurance recoveries from the SII Balance Sheet. The IM uses a transition matrix sourced from the ESG to model the rating of each reinsurer and the potential risk of default. The IM looks at each reinsurer separately and diversification will also reflect large concentrations with any one reinsurer.
- The SF calculates Operational Risk from percentage factors applied to TPs and Earned premiums split by Solvency II Lob. The IM derives Operational Risk from an Event Loss Table of MIICL-specific events collated in consultation with the business, using internal and external loss information to assist in the parameterisation. The SF assumes full correlation between the Basic SCR and Operational Risk whereas the Internal Model allows for diversification between these risk types.
- The IM uses the ESG to generate returns by asset class compared to the SF which applies a capital charge to the value of asset classes.

**6.5 Non-compliance with the MCR and non-compliance with the SCR**

The Company complied with the MCR and SCR requirements during the reporting period.

**6.6 Any other information**

Not applicable.

## 7 Glossary

Eiopa	European Insurance and Occupational Pensions Authority
FCA	Financial Conduct Authority
Fannie Mae	Federal National Mortgage Association
Freddie Mac	Federal Home Loan Mortgage Company
FRS102	Financial Reporting Standard 102
Ginnie Mae	Government National Mortgage Association
IM	Internal Model
Markel	Markel Corporation
MIICL	Markel International Insurance Company Limited
ACH	Alterra Capital Holdings Limited
MBL	Markel Bermuda Limited
MCAP	Markel Capital Limited
MCH	Markel Capital Holdings Limited
MCR	Minimum Capital Requirement
MEL	Markel Europe Limited
MIHL	Markel International Holdings (Delaware) Limited
MINT	Markel International Limited
MISL	Markel International Services Limited
MSM	Markel Syndicate Management Limited
Non Prop	Non Proportional
ORSA	Own Risk and Solvency Assessment
PRA	Prudential Regulation Authority
QRT	Quantitative Reporting Template

R&CC	Risk and Capital Committee
RI	Reinsurance
R0.xxx	Refers to a row within a QRT template.
SCR	Solvency Capital Requirement
SF	Standard Formula
SFCR	Solvency and Financial Condition Report
SII	Solvency II
SII Directive	Directive 2009/138/EC as amended by 2014/51/EU ("Omnibus II")
SII TPs	SII Technical Provisions
S.xx.xx.xx	Refers to a QRT template, for example S.02.01.02 refers to the SII Balance Sheet Template
The Company	MIICL
The Syndicate	Market Syndicate 3000
uSCR	SCR produced on a risks to ultimate basis

## 8 Appendices