MUNICIPAL MUTUAL INSURANCE LIMITED

(In Scheme of Arrangement)

Annual Report and Accounts

for the year ended 30 June 2018

Registered number: 76678 England

Website: www.mminsurance.co.uk

Municipal Mutual Insurance Limited
(In Scheme of Arrangement)
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CONTENTS

Municipal Mutual Insurance Limited
(In Scheme of Arrangement)

NOTICE OF MEETING

Notice is hereby given that the Annual General Meeting of the Company will be held at 3rd Floor, 23 College Hill, London EC4 on Thursday, 11 October 2018 at 12.30pm for the following purposes:

Ordinary resolutions

1. To receive and adopt the Annual Report and Accounts for the year ended 30 June 2018.

2. To appoint Sarah Ellis as a Director.

3. To appoint Kevin Gill as a Director.

4. To appoint Martin Walker as a Director.

5. To re-elect Gareth Hughes as a Director.

6. To re-appoint PricewaterhouseCoopers LLP as the independent auditors of the Company.

7. To authorise the Directors to fix the remuneration of the auditors.

Special Resolution

8. That the proposed new Articles of Association of the Company as produced to the meeting and initialled by the Chairman of the meeting for the purposes of identification be adopted as the Articles of Association of the Company in substitution for, and to the exclusion of, the existing Articles of Association of the Company (including those provisions of the Company's Memorandum of Association which, by virtue of section 28 of the Companies Act 2006, are treated as provisions of the Company's Articles of Association).

On behalf of the Board
G H Hughes
Director

6 September 2018

Registered Office
23 College Hill
London
EC4R 2RP

Note:

Any person entitled to attend and vote at the meeting is entitled to appoint a proxy to attend and vote in his or her stead. A proxy must be a member of the Company. A form of proxy is enclosed. This form of proxy, duly completed, and the power of attorney (if any) under which it is signed, must reach the registered office of the Company not later than noon on 10 October 2018.

Municipal Mutual Insurance Limited
(In Scheme of Arrangement)

SCHEME ADMINISTRATOR AND HIS DEPUTY, SENIOR MANAGEMENT AND CREDITORS' COMMITTEE

SCHEME ADMINISTRATOR

G H Hughes, FCA

DEPUTY SCHEME ADMINISTRATOR

R Barker, FCCA

NON-EXECUTIVE DIRECTORS

K Gill, ACA, ACII
Appointed Director 31 October 2017

M B A Walker
Appointed Director 31 October 2017

COMPANY SECRETARY

S Ellis, ACA

SENIOR MANAGEMENT

S Ellis, ACA – Chief Operating Officer
Appointed Director 31 October 2017

S Laird, ACA – Financial Controller

R Luck, ACII – Claims & Reinsurance Manager

CREDITORS' COMMITTEE MEMBERS AND THEIR ORGANISATIONS

A Prior, MA (Cantab) (Chairman)	Surrey County Council
J Barrett	West Midlands Police
H Dunn, CPFA	City of Edinburgh Council
Paul Guiliotti	Richmond and Wandsworth Council
K Jefferies	Financial Services Compensation Scheme
J Jopling, CPFA	Gateshead Council
D J Marshall-Rowan, LLB(Hons)	Leicestershire County Council
F Timms	Hertfordshire County Council

SCHEME ADMINISTRATOR'S STRATEGIC REVIEW

Introduction

I was appointed Scheme Administrator under the Scheme of Arrangement ('the Scheme') entered into by the Company and 729 of its principal insurance creditors ('the Scheme Creditors') under section 425 of the Companies Act 1985 (now section 899 of the Companies Act 2006), which was approved by Order of the Court on 5 January 1994 and came into effect on 21 January 1994.

The Scheme was a contingent Scheme, being held in reserve until the occurrence of a Trigger Event.

The Scheme was triggered by the Directors on 13 November 2012 (the 'Trigger Date') because they could no longer foresee a solvent run-off with full payment of agreed claims.

Since the Trigger Date, I have exercised general powers of management and control of the business, affairs and assets of the Company.

The Trigger Event denoted the commencement of the Levy Period under the terms of the Scheme. During the Levy Period, my responsibilities are to:

(a) manage the run-off of the Company's business;

(b) hold and, in due course, realise the assets of the Company and apply them for the benefit of the Scheme Creditors and the Financial Services Compensation Scheme ('FSCS'), and other creditors of the Company in accordance with the Scheme, and

(c) supervise and ensure the carrying out of the Scheme.

Results for the year

Profit for the year was £1.4 million (2017: profit of £4.4 million). Net assets are £nil (2017: deficit of £1.4 million). Under the terms of the Scheme of Arrangement, any net assets of the Company will ultimately be returned to Scheme Creditors through an adjustment to the payment percentage (see note 21). At the 30 June 2018 the Company has recognised a levy repayment liability of £3.3 million in its accounts which has reduced net assets to £nil.

The Company has followed a consistent policy by including the gross mid-range figure for IBNR (incurred but not reported) claims in its accounts, as calculated by KPMG LLP ('KPMG'). These estimates at 30 June 2018 remain in-line with the previously reserved position. No further reserve strengthening has been required this year.

The Company presents its results under FRS 102 'The Financial Reporting Standard, applicable in the UK and Republic of Ireland'. In accordance with FRS 102, the Company has identified its insurance contracts and accounted for them in accordance with FRS 103 'Insurance Contracts'.

Payment percentage and levy on Scheme Creditors

In accordance with the terms of the Scheme of Arrangement, I reviewed the financial position of the Company in March 2018 and concluded that the current payment percentage rate of 75%, set on 1 April 2016, remains appropriate. No further changes to the payment percentage and the levy rate are currently anticipated.

Investment policy

The Company's cash assets are invested by its investment managers, Aviva Investors Limited ('Aviva'), who continue to follow a risk-averse strategy on behalf of the Company with the aim of generating income and capital growth matched to the estimated cost and timing of current and forecast future liabilities. 68.1% of the current investment portfolio is invested in gilts, 30.4% is invested in corporate bonds and the balance is held as cash.

The outlook for investment in fixed rate products is challenging, given the UK's current economic environment of historically low gilt yields. The Company is placing reduced reliance on investment returns to support any foreseeable changes in claims run-off projections.

Creditors' Committee

Meetings of the Creditors' Committee were held on 12 October 2017 and 13 March 2018, at which Committee members were updated fully on all aspects of the progress of the run-off of the Company's business. I extend my thanks to the Committee for their continuing support in my role as Scheme Administrator.

Scheme Administrator's strategic review *continued*

There were a number of changes to the membership of the Committee during the year. In October 2017 Mr Paul Guiliotti replaced Mr Martin Walker as representative of Richmond and Wandsworth Council and in March 2018, Ms Janey Barrett was elected on to the Committee as a representative of West Midlands Police, who replaced the Housing Association as the non-local authority representative on the Committee. In addition, Mr Andrew Prior of Surrey County Council replaced Mr Martin Walker as Chair of the Committee in October 2017.

The next meeting of the Creditors' Committee will take place on 11 October 2018, prior to the Annual General Meeting.

Principal risks and uncertainties

In my opinion, the key business risks affecting the Company are as follows:

1. **Reserve risk – claims volatility**

   Claims volatility represents a continuing risk for the Company. A lower number of new mesothelioma claims were reported to MMI in the year, which continued the reversal of previous deteriorating trends; however significant uncertainty regarding the ultimate liability for this risk remains due to the long latency period from exposure to asbestos fibres to the development of the mesothelioma cancer and the potential for increased future costs in respect of developing immunotherapy treatments.

   A slightly higher number of new abuse claims were however reported to the Company in the year compared with 2017. Significant uncertainty remains regarding future numbers of this category of claim due to the unknown impact of factors such as: increased public awareness arising from publicity surrounding high profile abuse cases, the associated police and public body investigations, the Independent Inquiry into Child Sexual Abuse, the enactment of the Limitations (Childhood Abuse) (Scotland) Bill and recent Supreme Court decisions regarding local authoritys' vicarious liability in respect of children abused by foster carers.

2. **Investment risk – market and counterparty risk**

   Uncertainty over the interest rate environment represents a risk to the return on investments the Company can earn.

   The Company adopts a risk-averse investment strategy to manage its exposure to market and counter-party risk. Investment income is currently sufficient to cover the projected operating expenses of the run-off.

   The portfolio is invested in a portfolio of gilts and corporate bonds with the remainder in cash deposits. The portfolio is managed by Aviva Investment Managers under an investment management agreement. Performance and security of assets are closely monitored.

3. **Financial risk – liquidity**

   The Company's investments are held in highly liquid instruments and the Company monitors the liquidity of those investments quarterly to ensure that it always has access to sufficient funds to honour its cash outflow obligations as they fall due.

4. **Outsourcing risk**

   The Company has received assurances from third parties, in particular Zurich Insurance ('Zurich') and Aviva, that appropriate recovery plans are in existence in the event of unforeseen extended interruptions to the services which are provided to the Company.

5. **Human resource risk**

   The Company operates with a small team of experienced staff and therefore is exposed to key man risk. The Company actively manages this risk. It has succession plans in place for key personnel and can call on the resources of EY to assist with any temporary staff needs.

6. **Regulatory risk**

   The Company is regulated by the PRA and the FCA. The costs of regulatory compliance, particularly associated with Solvency II, have significantly increased in recent years. Changes to the legal or regulatory regimes in which the Company operates represent a risk to the run-off of the business.

Scheme Administrator's strategic review *continued*

Key performance indicators (KPIs)

The following KPIs are relevant to the Company's performance following the Scheme trigger:

1. **Outstanding claims**

   A comparison of the number of outstanding claims at the beginning and end of the year, after allowing for newly reported claims in the year, gives an indication of the progress made towards completion of the run-off. At 30 June 2018, there were 2,295 outstanding reported claims (30 June 2017: 2,666). In the year ended 30 June 2018, there were 693 newly reported claims (2017: 738).

2. **Investment income**

   The statistics relating to the investment income for the past two years are as follows:

	Year ended 30 June 2018 £000	*Year ended 30 June 2017 £000*
Investment funds at beginning of period	251,119	*177,213*
Investment funds at end of period	237,625	*251,119*
Average	244,372	*214,166*
Investment income	6,811	*5,814*
Investment Income as a percentage of average investment funds	2.79%	*2.71%*

Outlook

Following the updated Levy of 25% imposed on Scheme Creditors from 1 April 2016 in accordance with the Levy Notices, the Company will continue to pay claims at 75% of the agreed settlement amount for affected Scheme Creditors, and pay claims at 100% for non-Scheme Creditor policyholders.

Solvency II came into force on 1 January 2016. The directors are confident that the Company will continue to meet its regulatory requirements in the future. The Company publishes quantitative and qualitative information on Solvency II on an annual basis in its Solvency and Financial Condition Report ('SFCR'). The next SFCR will be prepared as at 30 June 2018.

Gareth Hughes
Scheme Administrator

6 September 2018

REPORT OF THE DIRECTORS

The Directors present their report and the audited accounts of the Company (registered number: 76678 England) for the year ended 30 June 2018. The Company is a company limited by guarantee and has no share capital. It is owned by its members.

Having assessed the principal risks, the Directors considered it appropriate to adopt the going concern basis of accounting in preparing the financial statements. Further details are presented in note 3(i) to the financial statements.

Activities

The principal activity of the Company during the year continued to be the run-off of its general insurance liabilities on policies issued up to 30 September 1992, the date on which the Company ceased to write general insurance business. Future Company developments are presented in the Outlook section of the Scheme Administrator's Strategic Review.

Scheme of Arrangement

The Company is subject to a Scheme of Arrangement ('the Scheme') under section 425 of the Companies Act 1985 (now section 899 of the Companies Act 2006) which became effective on 21 January 1994. The Scheme was held in reserve until 13 November 2012. On that date, the Directors resolved that a solvent run-off with full payment of agreed claims could no longer be foreseen and the Scheme was triggered, with responsibility for the Company's management passing to the Scheme Administrator, Mr Gareth Hughes. The Scheme trigger is irrevocable and the Directors undertook this course of action after concluding that it was in the best interests of Scheme Creditors, i.e. 729 of the largest insurance creditors who together formed the other party to the Scheme. In the opinion of the Directors, there were no viable alternatives to avoiding insolvent liquidation which might have been more advantageous to creditors.

The main consequences of triggering the Scheme of Arrangement are set out in the Scheme Administrator's Strategic Review on page 4.

Results for, and review of, the year to 30 June 2018

The results for the year ended 30 June 2018 are set out in the accounts on pages 15 to 27 and show a profit of £1.4 million (2017: profit of £4.4 million), which is net of a provision to return monies to Scheme Creditors of £3.3 million, as reported within the balance of technical provisions. This profit in the year is primarily attributable to a small positive movement on the technical account plus positive investment return.

In accordance with the Company's normal practice, the Directors received and accepted actuarial advice from KPMG to assist in establishing the undiscounted claims provisions as at 30 June 2018. This advice considers all the relevant factors which affect MMI's liability in relation to abuse, asbestos related disease and other claims and the estimated future incidence thereof. The Scheme Administrator agreed with the decision taken regarding the level of outstanding claims provisions to be included in the financial statements for the year ended 30 June 2018.

The majority of claims handling responsibilities are outsourced to Zurich. This service is provided, free of charge to the Company, until the conclusion of the run-off, and close liaison is maintained between the Company's staff and the claims teams of Zurich to ensure that service standards are maintained.

The profit of £1.9 million on the non-technical account compares with a profit of £1.1 million for the previous year.

Under the terms of the Scheme of Arrangement, Scheme Creditors are also entitled to additional payments of up to £30 million from any surplus reserves once all other liabilities have been met in full. No provision has been made for payment of any part of this £30 million commission for risk to Scheme Creditors, as such a payment arises only in the event of a solvent run-off.

Financial Instruments

Information on the use of financial instruments by the Company and its management of financial risk is disclosed in Note 6 to the financial statements. The Company's exposures to price risk, credit risk and liquidity risk are separately disclosed in that note.

Directors

The present Directors are shown on page 3.

Report of the Directors *continued*

Mr G Hughes retires by rotation in accordance with Article 39 of the Articles of Association and, being eligible, is recommended for re-election.

Ms Ellis, Mr Gill and Mr Walker were appointed Directors on 31 October 2017 in accordance with Article 33 of the Articles of Association until the date of the next Annual General Meeting. Being eligible, they are all recommended for re-election.

Indemnity insurance

A policy of indemnity insurance cover to the benefit of the Directors and Officers of the Company has been in force during the year ended 30 June 2018 and at the date of this report.

Directors' interests

By virtue only of Article 4(d) of the Articles of Association, the Scheme Administrator has agreed to become a member of the Company for his respective period of office but is not eligible for participation in any surplus funds falling for distribution to members at the conclusion of the Company's affairs. No Directors of the Company have any interests to declare.

Statement of Directors' responsibilities

Directors are responsible for preparing the Strategic Report, Report of the Directors and the financial statements in accordance with applicable law and regulations.

Company law requires Directors to prepare financial statements for each financial year. Under that law the Directors have prepared the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law). Under company law Directors must not approve the financial statements unless satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing the financial statements Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent;
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements;
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Statement of disclosure of information to auditors

In the case of the Directors at the date of this report:

(a) so far as the Directors are aware, there is no relevant audit information of which the Company's auditors are unaware, and

(b) the Directors have taken all the steps that they ought to have taken as Directors in order to make themselves aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

Independent auditors

A resolution to re-appoint PricewaterhouseCoopers LLP as the auditors of the Company will be proposed at the Annual General Meeting

Approved by the Board on 6 September 2018 and signed on its behalf.

G H Hughes
Director

DIRECTORS' STRATEGIC REPORT

Since the Scheme of Arrangement was triggered by the Directors on 13 November 2012, control of the Company passed to the Scheme Administrator who has exercised general powers of management and control of the business. The Strategic Report with which the Directors fully concur is included in the Scheme Administrator's Strategic Review on page 4.

Approved by the Board on 6 September 2018 and signed on its behalf.

G H Hughes
Director

INDEPENDENT AUDITORS' REPORT

Independent auditors' report to the members of Municipal Mutual Insurance Limited

Report on the audit of financial statements

Our opinion

In our opinion, Municipal Mutual Insurance Limited's financial statements:

- give a true and fair view of the state of the Company's affairs as at 30 June 2018 and of its profit and cash flows for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards, comprising FRS 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland", and applicable law); and
- have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements, included within the Annual Report and Accounts (the 'Annual Report'), which comprise: the Statement of Income and Retained Earnings for the year ended 30 June 2018, the Statement of Financial Position as at 30 June 2018 and the Statement of Cash Flows for the year ended 30 June 2018; and the notes to the financial statements, which include a description of the significant accounting policies.

Our opinion is consistent with our reporting to the Audit Committee.

Basis of opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ('ISAs (UK)') and applicable law. Our responsibilities under ISAs (UK) are further described in the Auditors' responsibilities for the audit of the financial statements section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

We remained independent of the company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, which includes the FRC's Ethical Standard, as applicable to public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

To the best of our knowledge and belief, we declare that non-audit services prohibited by the FRC's Ethical Standard were not provided to the company.

We have provided no non-audit services to the company in the period from 1 July 2017 to 30 June 2018.

Emphasis of matter – Significant uncertainties in estimating the provision for gross claims outstanding

In forming our opinion on the financial statements, which is not modified, we have considered the adequacy of the disclosures made in Note 6 to the financial statements concerning the significant uncertainties in estimating provisions for gross claims outstanding, in particular for mesothelioma and abuse claims, the ultimate settlement value of which could vary materially from the amounts recorded in the financial statements.

Independent Auditors' report *continued*

Our audit approach

Overview

- Overall materiality: £2,589,000 (2017: £2,756,000), based on 1% of Total Liabilities.
- We performed a full scope audit of the complete financial information of the entity in accordance with our materiality and risk assessment.
- Significant uncertainties in estimating the valuation of reserves.

The scope of our audit

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the financial statements. In particular, we looked at where the directors made subjective judgements, for example in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain.

We gained an understanding of the legal and regulatory framework applicable to the company and the industry in which it operates, and considered the risk of acts by the company which were contrary to applicable laws and regulations, including fraud. We designed audit procedures to respond to the risk, recognising that the risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting one resulting from error, as fraud may involve deliberate concealment by, for example, forgery or intentional misrepresentations, or through collusion. We focused on laws and regulations that could give rise to a material misstatement in the company's financial statements, including, but not limited to, the Companies Act 2006. Our tests included, but were not limited to, review of the financial statement disclosures to underlying supporting documentation. There are inherent limitations in the audit procedures described above and the further removed non-compliance with laws and regulations is from the events and transactions reflected in the financial statements, the less likely we would become aware of it.

We did not identify any key audit matters relating to irregularities, including fraud. As in all of our audits we also addressed the risk of management override of internal controls, including testing journals and evaluating whether there was evidence of bias by the directors that represented a risk of material misstatement due to fraud.

Independent Auditors' report *continued*

Key audit matters

Key audit matters are those matters that, in the auditors' professional judgement, were of most significance in the audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by the auditors, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. These matters, and any comments we make on the results of our procedures thereon, were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. This is not a complete list of all risks identified by our audit.

Key audit matter

Significant uncertainties in estimating the valuation of reserves

Total claims outstanding for the year ended 30 June 2018 are £258 million. The methodologies and assumptions utilised to develop outstanding claims reserves involve a significant degree of judgement as there is generally less information available with the related claims. The liabilities are based on the estimated ultimate cost of all claims incurred but not settled at a given date.

In addition, certain classes of business, such as Employers' Liability and Public Liability are inherently more uncertain than others and the ultimate cost of such claims is more likely to vary as a result of subsequent developments. Provisions on these classes include substantial amounts for asbestos related and abuse claims.

Asbestos related claims tend to display greater variability between initial estimates and final settlements due to the long latency period. The estimated liability for these claims is very sensitive to the actuarial assumptions. Valuing the liability for abuse claims is also highly subjective due to uncertainty around the future development of these claims.

We focused on this area as the underlying methods include a number of management assumptions relating to the expected settlement amounts and settlement patterns of claims and are subject to complex calculations which include application of management's judgement.

See notes 3, 5 and 6 of the financial statements for disclosures of related accounting policies, judgements and estimates.

How our audit addressed the key audit matter

In order to challenge management's assumptions and methodologies, we were assisted by our actuarial specialist team members who performed independent re-projections on selected classes of business, particularly focusing on the higher risk Employers' Liability asbestos and Public Liability abuse claims, which constitute the largest and most volatile reserves for MMI.

For these classes, we considered the appropriateness of the estimates by considering the sensitivity of the reserves to the key methods and assumptions used by management. We also considered the development of the historical estimates to assess the settlement pattern for these claims.

For the remaining classes, we performed testing of key indicators to identify and follow up any anomalies and assessed whether there was any audit evidence that was inconsistent with our knowledge of these claims from the independent projections noted above. No material differences were identified in our procedures performed.

How we tailored the audit scope

We tailored the scope of our audit to ensure that we performed enough work to be able to give an opinion on the financial statements as a whole, taking into account the structure of the company, the accounting processes and controls, and the industry in which it operates.

Independent Auditors' report *continued*

Materiality

The scope of our audit was influenced by our application of materiality. We set certain quantitative thresholds for materiality. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures on the individual financial statement line items and disclosures and in evaluating the effect of misstatements, both individually and in aggregate on the financial statements as a whole.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

Overall materiality	£2,589,000 (2017: £2,756,000).
How we determined it	1% of Total Liabilities.
Rationale for benchmark applied	We believe that total liabilities is the primary measure used by the members in assessing the performance and financial position of the entity.

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above £129,400 (2017: £137,800) as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

Conclusions relating to going concern

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

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

However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the company's ability to continue as a going concern.

Reporting on other information

The other information comprises all of the information in the Annual Report other than the financial statements and our auditors' report thereon. The directors are responsible for the other information. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except to the extent otherwise explicitly stated in this report, any form of assurance thereon.

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

With respect to the Strategic Report and Report of the Directors, we also considered whether the disclosures required by the UK Companies Act 2006 have been included.

Based on the responsibilities described above and our work undertaken in the course of the audit, ISAs (UK) require us also to report certain opinions and matters as described below.

Strategic Report and Report of the Directors

In our opinion, based on the work undertaken in the course of the audit, the information given in the Strategic Report and Report of the Directors for the year ended 30 June 2018 is consistent with the financial statements and has been prepared in accordance with applicable legal requirements.

In light of the knowledge and understanding of the company and its environment obtained in the course of the audit, we did not identify any material misstatements in the Strategic Report and Report of the Directors.

Independent Auditors' report *continued*

Responsibilities for the financial statements and the audit

Responsibilities of the directors for the financial statements

As explained more fully in the Statement of Directors' Responsibilities set out on page 8, the directors are responsible for the preparation of the financial statements in accordance with the applicable framework and for being satisfied that they give a true and fair view. The directors are also responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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

Auditors' responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

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

Use of this report

This report, including the opinions, has been prepared for and only for the company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Other required reporting

Companies Act 2006 exception reporting

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- we have not received all the information and explanations we require for our audit; or
- adequate accounting records have not been kept by the company, or returns adequate for our audit have not been received from branches not visited by us; or
- certain disclosures of directors' remuneration specified by law are not made; or
- the financial statements are not in agreement with the accounting records and returns.

We have no exceptions to report arising from this responsibility.

Appointment

Following the recommendation of the audit committee, we were appointed by the directors on 17 May 1985 to audit the financial statements for the year ended 30 June 1986 and subsequent financial periods. The period of total uninterrupted engagement is 33 years, covering the years ended 30 June 1986 to 30 June 2018.

Philip Watson (Senior Statutory Auditor)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London

6 September 2018

(a) The maintenance and integrity of the Municipal Mutual Insurance Limited 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 financial statements since they were initially presented on the website.

(b) Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

MUNICIPAL MUTUAL INSURANCE LIMITED
(In Scheme of Arrangement)

STATEMENT OF INCOME AND RETAINED EARNINGS
for the year ended 30 June 2018

	Note	2018		*2017*	
		£000	**£000**	*£000*	*£000*
Technical account					
Claims (paid)/recovered					
Gross amount		**(15,979)**		*(11,814)*	
Reinsurers' share		**(449)**		*90*	
Net claims (paid)			**(16,428)**		*(11,724)*
Change in provisions for claims					
Gross amount		**16,808**		*14,026*	
Reinsurers' share		**(800)**		*1,000*	
Change in net provisions for claims			**16,008**		*15,026*
Claims (incurred)/recovered net of reinsurance	7		**(420)**		*3,302*
Balance on technical account for general business			**(420)**		*3,302*
Non-technical account					
Investment Income					
Income from investments		**6,811**		*5,814*	
Net (loss)/gain on realisation of investments		**(236)**		*6,085*	
			6,575		*11,899*
Net unrealised (loss) on investments		**(1,874)**		*(5,860)*	
Investment expenses and charges		**(212)**		*(190)*	
			(2,086)		*(6,050)*
Other charges	8	**(2,637)**		*(4,772)*	
			(2,637)		*(4,772)*
Profit on ordinary activities before tax			**1,432**		*4,379*
Tax on profit on ordinary activities	13		**–**		*–*
Profit on ordinary activities after tax			**1,432**		*4,379*
Total comprehensive income			**1,432**		*4,379*
Retained earnings					
Retained earnings brought forward			**(1,432)**		*(5,811)*
Profit on ordinary activities after tax			**1,432**		*4,379*
Retained earnings carried forward			**–**		*(1,432)*

MUNICIPAL MUTUAL INSURANCE LIMITED
(In Scheme of Arrangement)

STATEMENT OF FINANCIAL POSITION
as at 30 June 2018

	Note	2018		2017	
		£000	£000	£000	£000
Investments					
Other financial investments	14		**237,625**		*251,119*
Reinsurers' share of technical provisions					
Claims outstanding	3(iii)		**13,450**		*14,250*
Debtors					
Debtors arising out of reinsurance operations		–		*509*	
Other debtors		**4,093**		*5,001*	
			4,093		*5,510*
Other assets					
Tangible fixed assets	15	**122**		*171*	
Cash and cash equivalents		**3,648**		*3,179*	
			3,770		*3,350*
Total Assets			**258,938**		*274,229*
Technical provisions					
Gross amount of claims outstanding	6(i)	**(258,029)**		*(274,837)*	
Creditors					
Other creditors including taxation and social security	16	**(909)**		*(824)*	
Total liabilities			**(258,938)**		*(275,661)*
Net assets/(liabilities)			–		*(1,432)*
Retained earnings brought forward			**(1,432)**		*(5,811)*
Profit on ordinary activities after tax			**1,432**		*4,379*
Profit and loss account			–		*(1,432)*

The financial statements on pages 15 to 27 were approved by the Board of Directors on 6 September 2018 and signed on its behalf by

G H Hughes
Director

K Gill
Director

STATEMENT OF CASH FLOWS
for the year ended 30 June 2018

	Note	2018	*2017*
		£000	*£000*
Net cash (outflow) from operating activities	17	**(17,802)**	*(14,267)*
Investing activities			
Interest received		**6,901**	*5,060*
Payments to acquire tangible fixed assets		**(14)**	*(2)*
Payments to acquire investments: UK gilts, debentures and floating rate notes		**(28,918)**	*(220,917)*
Receipts from sales of investments: UK gilts, debentures and floating rate notes		**40,302**	*147,236*
Net cash flow from investing activities		**18,271**	*(68,623)*
Increase/(decrease) in cash and cash equivalents		**469**	*(82,890)*
Cash and cash equivalents at 1 July		**3,179**	*86,069*
Increase/(decrease) in cash and cash equivalents in period		**469**	*(82,890)*
Cash and cash equivalents at 30 June	17	**3,648**	*3,179*

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2018

1 General information

Municipal Mutual Insurance Limited is a limited liability company, limited by guarantee and incorporated in England. The Registered Office is 23 College Hill, London EC4R 2RP.

2 Statement of compliance

The financial statements of Municipal Mutual Insurance Limited have been prepared in compliance with United Kingdom Accounting Standards, including Financial Reporting Standard 102, "The Financial Reporting Standard applicable in the United Kingdom and the Republic of Ireland" ('FRS 102'), Financial Reporting Standard 103, "Insurance Contracts" ('FRS 103') and the Companies Act 2006. They have also been prepared in compliance with the provisions of the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations relating to insurance companies.

3 Summary of significant accounting policies

(i) Going Concern

The Company ceased writing insurance business on 30 September 1992. To ensure an orderly run-off, a contingent Scheme of Arrangement (the 'Scheme') under section 425 of the Companies Act 1985 (now section 899 of the Companies Act 2006) was put in place and became effective on 21 January 1994. Under the terms of the Scheme, the Directors continued to pay all creditors in full until they resolved on 13 November 2012 that a solvent run-off with full payment of agreed claims could no longer be foreseen. On that date, the Scheme was triggered and responsibility for the Company's management passed to the Scheme Administrator, Mr Gareth Hughes.

The Scheme trigger is irrevocable and the Directors undertook this course of action only after concluding that there were no viable alternatives to avoiding insolvent liquidation which might have been more advantageous to creditors than triggering the Scheme.

As a consequence of triggering the Scheme, up to 729 of the largest insurance creditors, the Scheme Creditors, of the Company have undertaken to accept partial payment of agreed claims, i.e. at less than 100% of the full settlement amount. Recoveries in respect of past claims paid since 30 September 1993 will be achieved by means of one or more percentage levies imposed by the Scheme Administrator on Scheme Creditors after having undertaken a review of the Company's assets and liabilities as at the trigger date of 13 November 2012 and subsequently in each calendar year. The first £50,000 of claims payments to each Scheme Creditor is exempt from levy. Future claims payments will be reduced by equivalent percentages. Creditors other than Scheme Creditors will continue to be paid in full throughout the run-off period.

The Scheme Administrator has imposed a Payment Percentage of 75%, therefore reducing amounts paid on claims in respect of Scheme Creditors by 25%. This percentage applies to all applicable Scheme Creditor claims paid since 30 September 1993 and has either been deducted at the point of payment or recovered by means of a levy.

In arriving at the Payment Percentage of 25%, assumptions have been made regarding the level of provision made for outstanding claims, future investment income and operating costs, all of which factors are subject to varying degrees of uncertainty. The provision for outstanding claims (including claims incurred but not reported) is reported net of this 25%, equivalent to £78.7 million.

The Directors are of the opinion that the operation of the Payment Percentage mechanism ensures that any future balance sheet deficit could be eliminated by adjusting this percentage applicable to Scheme Creditors as necessary, and that it is therefore appropriate for the financial statements to continue to be prepared on the going concern basis.

(ii) Claims (incurred)/recovered

Claims (incurred)/recovered comprise claims and related expenses paid in the year and changes in provisions for outstanding claims, including provisions for claims incurred but not reported and related expenses. Claims recovered include the amount receivable from Scheme Creditors in respect of the Levy imposed by the Scheme Administrator. Outstanding claims, including provisions for claims incurred but not reported have been reduced to reflect the effect of the Levy. Where applicable, deductions are made for recoveries.

The provision for outstanding claims comprises the estimated cost of claims notified but not settled at the date of the balance sheet together with the estimated cost of claims incurred but not reported at that date, after reduction to reflect the effect of the Levy. Claims provisions are calculated gross of any reinsurance recoveries and are not discounted. Independent actuarial advice has been received to assist the Directors in establishing the provision for claims incurred but not yet reported at the date of the balance sheet. Note 6 gives further details of the basis on which provision is made.

(iii) Reinsurance

Reinsurers' share of technical provisions are estimates based upon gross provisions for outstanding claims, having due regard to collectability (note 6). Reinsurance recoveries in respect of estimated claims incurred but not reported are assumed to be consistent with the historical pattern of claims reported to date, adjusted to reflect changes in the nature and extent of the Company's reinsurance programme over time. The recoverability of reinsurance recoveries is assessed having regard to market data on the financial strength of each of the reinsurance companies. The reinsurers' share of claims incurred, in the profit and loss technical account, reflects the amounts received or receivable from reinsurers in respect of those claims incurred during the period.

(iv) Taxation

Taxation expense for the period comprises current and deferred tax recognised in the reporting period. Tax is recognised in the profit and loss account, except to the extent that it relates to items recognised in other comprehensive income. In this case tax is also recognised in other comprehensive income. Current or deferred taxation assets and liabilities are not discounted.

3 Summary of significant accounting policies *continued*

Current tax

Current tax is the amount of income tax payable in respect of the taxable profit for the year or prior years. Tax is calculated on the basis of tax rates and laws that have been enacted or substantively enacted by the period end.

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

Deferred tax

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

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

Deferred tax is measured using tax rates and laws that have been enacted or substantively enacted by the period end and that are expected to apply to the reversal of the timing difference.

(v) Tangible fixed assets

Tangible fixed assets are capitalised and depreciated by equal annual instalments over their estimated useful lives. The principal estimates used are as follows:

Office equipment	3 to 5 years	
Fixtures and fittings	lesser of:	– 10 years, and, where leasehold property – the unexpired minimum lease term

(vi) Financial assets

Financial assets represent debt and other fixed income securities held in the form of gilts, debentures and floating rate notes. In accordance with the provisions of FRS102, Sch 11, these assets are classified as fair value through the profit or loss.

(a) Investment income

Interest is included in the profit and loss non-technical account on an accruals basis.

(b) Investment gains and losses

Realised gains and losses on investments are calculated as the difference between sales proceeds and the cost of acquisition, together with any diminution in the value of the Company's assets which is considered to be permanent.

The movement in unrealised gains and losses on investments represents the difference between the valuation at the balance sheet date and their purchase price or, if they have been previously valued, their valuation at the last balance sheet date, together with the reversal of unrealised gains and losses recognised in earlier accounting periods in respect of investment disposals in the current year. The aggregate realised and unrealised surplus or deficit is taken to the profit and loss non-technical account.

(vii) Pensions

The Company operates a Workplace Pension Scheme, a defined contribution scheme. Contributions to the Workplace Pension Scheme are made by the Company based upon amounts of salary sacrificed by each employee and are charged to the profit and loss non-technical account as incurred. The Plan requires a minimum staff contribution of 5% of pensionable salary and the Company contributes an additional 4%.

(viii) Operating Leases

The company has a sole operating lease, being the leasehold agreement for part of the Third Floor, 23 College Hill. This lease commenced on 11 February 2015 and has a 10-year term with a mutual break at 19 May 2020. From 20 Nov 2019 to 19 May 2020 there is a rent-free period. The benefit of this rent-free period is incurred evenly over the initial rental term, 11 February 2015 to 19 May 2020. In the event of the mutual break not being exercised the Company is entitled to a further 3 months' rent-free period from the date of the break.

4 Effects of triggering the Scheme of Arrangement

After carrying out a review of the Company's assets and liabilities as at the trigger date of 13 November 2012, in January 2014 the Scheme Administrator imposed an initial Levy on Scheme Creditors amounting to £104.5 million being 15% of aggregate claims payments made since 30 September 1993, after deduction of the first £50,000 of such payments to each Scheme Creditor which is free of Levy. The Levy has been accounted for through claims (paid)/recovered in the Statement of Income and retained earnings. From 1 April 2016, this levy percentage was raised from 15% to 25% and additional levy notices issued amounting to £72.6m. The provision for outstanding claims, including claims incurred but not reported, has been reduced in line with this payment percentage.

5 Critical accounting judgements and estimation uncertainty

Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

(i) Significant judgements in applying the accounting policies

Estimates of insurance liabilities for claims received but not settled are subject to the professional judgement of the claims handler assigned to handle the claim. Initial estimates are set with due regard to Company guidelines based upon claims settlement history and these estimates are subject to on-going review and refinement as further details of the claims emerge. Claims handling is further discussed in note 6.

(ii) Sources of estimation uncertainty

The Company makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are addressed below.

(a) The ultimate liability arising from claims made under insurance contracts

The estimation of the ultimate liability arising from claims made under insurance contracts is the Company's most critical accounting estimate. The carrying amount of the liability is £258.0m (2017: £274.8m). The most significant assumptions made relate to the level of future claims and the level of future claims settlements. Whilst the directors consider that the gross provision for claims and the related reinsurance recoveries are fairly stated based on the information currently available to them, the ultimate liability will vary as a result of subsequent information and events and may result in significant adjustments to the amount provided. Adjustments to the amounts of provision are reflected in the financial statements for the period in which the adjustments are made.

(b) Fair value of financial instruments

The Company holds financial investments comprising of UK gilts, debentures and floating rate notes with a carrying value of £237.6m (2017: £251.1m). Valuation of these assets at the year-end is based on quoted market prices.

6 Management of Insurance and financial risk

The Company ceased underwriting insurance business on 30 September 1992, but is exposed to insurance risk from claims arising on policies underwritten prior to this date. The company is also exposed to a range of financial risks through its financial assets, reinsurance assets and policyholder liabilities. This section summarises these risks and the way the Company manages them.

(i) Insurance risk

Provision is made in the accounts for the estimated cost of claims notified but not settled at the date of the balance sheet and for the estimated cost of claims incurred but not reported at that date. Claims provisions are not discounted for inclusion in the accounts, but are reduced to reflect the effect of the Scheme payment percentage (note 4).

Claims provisions have been made with appropriate prudence, having regard to past claims experience, current judicial interpretations of the law and other relevant information. However, no allowance has been made for any new categories of claim not so far reflected in the experience seen. Furthermore, the inherent uncertainty of the insurance process makes it likely that historical data will not be wholly predictive of the actual future emergence and development of claims. A substantial measure of judgement is involved in both establishing the individual claims provisions and in interpreting past claims experience as part of the process of establishing the total claims provision. Certain classes of business, such as Employers' Liability and Public Liability are inherently more uncertain than others and the ultimate cost of such claims is more likely to vary as a result of subsequent developments. Provisions on these classes include substantial amounts for asbestos related and abuse claims. Asbestos related claims can be subject to very long delay in reporting losses, since the onset of illness and disability arising from the exposure to harmful conditions may only become apparent many years later; in cases of mesothelioma this latency period can be anything between 10 and 40 years. The major risk classes of claims identified by the business are therefore child abuse and mesothelioma.

Each year-end, the Directors instruct their actuarial advisors, KPMG, to produce three range estimates of claims outstanding corresponding to a high, mid and low forecast of potential future claims liabilities. These estimates do not represent the minimum and maximum estimates of future liability, but provide a range of outcomes in which the ultimate liability may reasonably fall. In producing their estimates, the actuaries make use of a range of data sources including historical company information, industry-wide reports and relevant supplementary population data.

Child abuse claims are outsourced to Zurich and are handled in the Zurich Farnborough office by members of the Complex Claims Team ('CCT'), a dedicated team dealing with high profile, complex and high value claims for Zurich and MMI. MMI has retained a small portfolio of high profile and complex claims in-house. All new child abuse claims are reported to MMI, enabling MMI to review policy cover and provide input into specific issues identified. Following a significant increase in child abuse claim notifications in recent years, MMI has undertaken a process to broaden the provision of claims data made available to the actuaries, allowing them to further stratify their claims forecasts.

MMI manages mesothelioma claims through Zurich's dedicated disease claims handling team in Birmingham. Zurich has more than 20 years' experience underwriting and claims handling Local Authority business. The Birmingham disease team has been the centre of Zurich's disease claims handling for over 15 years and has handled the municipal claims since 2008.

Claims handlers of mesothelioma claims at Zurich are senior claims handlers with high levels of experience needed to meet the complexity and financial value of these cases. Zurich has a specific Mesothelioma Claims Handling Guide setting out information and procedures on all aspects of mesothelioma claims handling. MMI monitors progress of all mesothelioma claims, controlled by the Claims and Reinsurance Manager. In addition, files representing between 20%-25% of settled claims are fully reviewed by MMI. Mesothelioma claims are partly mitigated by a reinsurance recovery program.

6 Management of Insurance and financial risk *continued*

MMI has considered the potential impact of the change to the Ogden discount rate announced in February 2017. The major impact will be on mesothelioma claims where settlement almost always involves a lost years or dependency claim calculated on a multiplier/multiplicand basis. The impact of the change is lessened as most claimants are older; the average age is 75, they tend not to have been high earners and life expectancy can be affected by other unconnected medical conditions. MMI continually monitors the average cost of settlements and considers its current reserving practice sufficient to accommodate these increases. Other claims likely to be affected are asbestosis, vibration white finger and lung cancer, but numbers are low so the impact will be minimal, and child abuse. Abuse claims however, rarely involve settlement of damages on a multiplier/multiplicand basis.

(a) Sensitivity analysis of claims estimation

Sensitivity analysis is provided by the actuarial forecasts, whereby each low, mid and high forecast provides differing assumptions as to the number of future claims notified, the average settlement amount and the rate of claims inflation. MMI has adopted the mid-case for these financial accounts. The claims liability estimates under the low, mid and high assumptions, along with the key variable assumptions for the mesothelioma and abuse classes are given below:

		Mesothelioma Assumptions			*Abuse Assumptions (non-institutional)*		
	gross claims Outstanding £000	*MSO claims inflation p.a.*	*Average Settlement 2018 (£)**	*No of Future Claims*	*ABU claims inflation p.a.*	*Average Settlement 2018 (£)*	*No of Future Claims*
LOW	**235,241**	*3.00%*	*Base*	*989*	*2.00%*	*Base*	*1,423*
MID	**336,741**	*4.50%*	*Base*	*1,143*	*3.00%*	*Base*	*2,556*
HIGH	**491,641**	*6.00%*	*Base+6.1%*	*1,359*	*4.00%*	*Base+13.7%*	*3,155*

* A base settlement for claims is calculated on the basis of recent claims settlement history and includes all legal and other sundry associated costs of settlement.

(b) Claims development table

All outstanding claims liabilities relate to claims underwritten prior to 30 September 1992. The following table reflects the development of claims paid and outstanding over the previous seven financial years:

	Claims Outstanding – £000			**Claims Paid – £000**		
financial year ended 30 June	*Gross claims outstanding*	*Reduction for payment percentage**	**Gross claims outstanding after payment percentage**	*Gross paid claims net of recoveries before levy*	*Reduction for levy and payment percentage**	**Gross claims paid/ (recovered)**
2012	275,266	–	**275,266**	14,933	–	**14,933**
2013	289,739	(40,215)	**249,524**	17,543	(100,000)	**(82,457)**
2014	340,899	(49,172)	**291,727**	13,013	(5,179)	**7,834**
2015	383,533	(55,380)	**328,153**	13,892	(2,191)	**11,701**
2016	381,928	(93,065)	**288,863**	14,328	(75,037)	**(60,709)**
2017	362,054	(87,217)	**274,837**	17,713	(5,899)	**11,814**
2018	336,741	(78,712)	**258,029**	17,958	(1,979)	**15,979**

* The Scheme of Arrangement provides a mechanism by which the Company can mitigate its insurance risk. The Scheme of Arrangement gives the Scheme Administrator the power to adjust the payment percentage applicable to claims to reflect the financial position of the Company; it also gives the Scheme Administrator the power to recover past payments in excess of the payment percentage through a levy. An initial payment percentage of 85% was set on 1 January 2014. The current payment percentage of 75% was set on 1 April 2016. A Levy of 15% was made on Scheme Creditors on 1 January 2014 and a further 10% was made on 1 April 2016. Under the Scheme of Arrangement, the Payment Percentage will be adjusted to reflect the changing financial circumstances of the Company throughout the run-off of its claim liabilities, ensuring that all Scheme Creditors receive an equitable share of the Company's assets. The Company remains liable for all unpaid liabilities until the conclusion of the run-off of the Company. If there are insufficient assets to pay liabilities in full at conclusion, then final payment will be made to Scheme Creditors on a pro-rata basis. If surplus assets exist at the conclusion of the run-off, the Scheme Creditors will receive a pro-rata share of the first £30 million of the surplus.

To the extent that the Company would otherwise report a surplus of net assets, the reduction in claims outstanding for the repayment percentage is restricted by this asset surplus to reflect the obligation to repay monies previously raised by the levy/payment percentage mechanism (see note 21: Contingent liabilities). As at 30 June 2018 the reduction for the payment percentage of £78.7m (2017: £87.2m) has been restricted by £3.3m (2017: £nil) to reflect this notional surplus.

(ii) Financial Risk and management objectives

The Company's primary financial risk is that proceeds from financial assets are not sufficient to meet its claims settlement obligations due under the run-off its insurance business. The main components of this risk are market risk, credit risk and liquidity risk.

Throughout the run-off period the Company has followed a risk-averse investment strategy. This strategy is "to acquire secure assets which will generate income and capital growth to meet as far as practicable the cost of current and future liabilities pursuant to the insurance business of the Company".

6 Management of Insurance and financial risk *continued*

As the Company has no premium income, the underlying security of the investment portfolio is paramount to ensure that the income generated is available to contribute towards payment of claims and operating expenses. The portfolio is invested in gilts, corporate bonds and floating rate notes, with the remainder in cash deposits.

(a) Interest Rate Risk

Interest rate risk arises primarily from investments in fixed interest securities. In addition, to the extent that claims inflation is correlated with interest rates, liabilities to policyholders are exposed to interest rate risk. The Company seeks to mitigate this risk, by matching, as far as is practical, the maturity of fixed interest investments to the forecast settlement profile of outstanding claims.

The sensitivity of interest rate risk illustrates how the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates at the reported date

	2018 £000	**Change £000**	*2017 £000*	*Change £000*
Financial assets at fair value through the profit and loss	**237,625**		*251,119*	
Sensitivities:				
Fair value following 100bps increase in interest yields	**216,435**	**(21,190)**	*228,325*	*(22,794)*
Fair value following 100bps decrease in interest yields	**262,423**	**24,798**	*277,905*	*26,786*

The increase/(decrease) in valuation would be accounted for through the profit and loss for the period. The financial assets are held as UK gilts and corporate bonds and the interest received on these assets held would not change in response to a change in interest rates. The redemption values would likewise be unchanged – thereby gains or losses arising from the interest rate change would unwind as the assets reach maturity.

(b) Credit risk

Credit risk is the risk that a counterparty will be unable to pay amounts in full when due. Key areas where the Company is exposed to credit risk are:

- amounts due from issuers of corporate bonds and similar fixed income products;
- reinsurers' share of insurance liabilities
- amounts due from reinsurers in respect of claims already paid

The Company's Investment Management Agreement sets limits on the range of investments the Company's investment managers can make on its behalf, specifically all investments must be AAA or AA rated. Except for UK gilts and supranational bonds, the maximum exposure to any counterparty is limited to the lesser of 5% of the portfolio valuation or £15 million.

The assets bearing credit risk are summarised below, together with an analysis by credit rating

	2018 £000	*2017 £000*
Gilts, debentures and similar debt securities	**237,625**	*251,119*
Reinsurers' claims outstanding	**13,450**	*14,250*
Total assets bearing credit risk	**251,075**	*265,369*
AAA	**37,083**	*31,213*
AA	**211,064**	*231,079*
A	**1,012**	*1,142*
BBB	**152**	*151*
Not Rated	**1,764**	*1,784*
Total assets bearing credit risk	**251,075**	*265,369*

(c) Liquidity Risk

Liquidity risk is the risk that cash may not be available to pay obligations when due at a reasonable cost. The primary liquidity risk of the Company is the obligation to pay claims to policy holders as they fall due. These claims are projected to remain payable for in excess of 30 years. Any long-term shortfall in claims coverage identified by the annual actuarial forecast will be met through the Scheme of Arrangement levy mechanism.

Short term liquidity requirements are met by transfers of funds from investments to cash. Under the Company's Investment Management Agreement, a minimum target of £2.0m is set for same day transfer and £10m of funds must be made available within 5 working days on request.

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2018

6 Management of Insurance and financial risk *continued*

The projected settlement of the Company's liabilities is given below:

Financial Liabilities and outstanding claims	**<1 year £000**	**Between 1 year and 5 years £000**	**Between 5 years and 10 years £000**	**>10 years £000**	**Total £000**
At 30 June 2018:					
Outstanding claims	**13,317**	**53,092**	**63,378**	**128,242**	**258,029**
Other Creditors	**909**	**–**	**–**	**–**	**909**
	14,226	**53,092**	**63,378**	**128,242**	**258,938**

Financial Liabilities and outstanding claims	*<1 year £000*	*Between 1 year and 5 years £000*	*Between 5 years and 10 years £000*	*>10 years £000*	*Total £000*
At 30 June 2017:					
Outstanding claims	13,900	61,594	71,909	127,434	274,837
Other Creditors	824	–	–	–	824
	14,724	61,594	71,909	127,434	275,661

(d) Fair value estimation

Financial instruments carried at fair value can be categorised by the following valuation methods:

Level 1 Quoted prices in an active market

Level 2 Recent transactions in an identical asset if there is an unavailability of quoted prices

Level 3 Use of a valuation technique if there is no active market or other transactions which are a good estimate of fair value.

The Company's financial investments of £237.6 million (2017 £251.1 million) comprise of UK Gilts, debentures and similar debt securities. They are all categorised as level 1.

7 Segmental Information

Incurred claims	**2018 Gross £000**	**2018 Reinsurance ceded £000**	**2018 Net £000**	*2017 Gross £000*	*2017 Reinsurance ceded £000*	*2017 Net £000*
Third party liability	**7,368**	**(1,249)**	**6,119**	*2,165*	*1,090*	*3,255*
Other direct	**(13)**	**–**	**(13)**	*(4)*	*–*	*(4)*
Levy adjustment	**(6,526)**	**–**	**(6,526)**	*51*	*–*	*51*
	829	**(1,249)**	**(420)**	*2,212*	*1,090*	*3,302*

No note on movement in prior years' claims provisions has been presented because the Company is in run-off and therefore such information is represented by the Statement of Income and Retained Earning shown on page 15. All business results from contracts concluded in the UK.

8 Other charges

	2018 £000	*2017 £000*
Operating lease rentals – leasehold property	**149**	*149*
Other administration costs	**2,488**	*4,623*
Total other charges	**2,637**	*4,772*

Claims handling for the Company is undertaken by Zurich at no charge and therefore all expenses have been included in the profit and loss non-technical account.

9 Employee information

The monthly average number of persons (including executive Directors) employed by the Company during the year was 5 (2017: 4). All staff are employed in the run-off administration of the Company.

Staff costs for the above persons were:

	2018 £000	*2017 £000*
Wages and salaries, including amounts sacrificed as pension contributions (Note 11)	534	*747*
Social security costs	71	*42*
Other pension costs – contributions by Company	21	*13*
	626	*802*

10 Directors' Emoluments and Scheme Administrator's fees

	2018 £000	*2017 £000*
The aggregate emoluments paid to Directors in respect of qualifying services were	213	*397*
The amount included above in respect of the highest paid Director was	112	*397*
The number of Directors who were accruing benefits under the defined contribution pension scheme was	1	*–*

The emoluments of Directors are set by the Company's Remuneration Committee and are subject to the approval of the Scheme Administrator.

At 30 June 2018, the Company had 4 Directors (2017: 2).

An analysis of the remuneration package of the executive Directors is set out below:

	Salary £000	Benefits In kind £000	Total 2018 £000	*Total 2017 £000*
S Ellis (Appointed 31 Oct 2017)	101	11	112	*–*
I A Willett (Left 30 Sep 2016)	–	–	–	*397*
	101	11	112	*397*

An analysis of the fees paid to the non-executive Director is set out below:

	Total 2018 £000	*Total 2017 £000*
M Walker (Appointed 31 Oct 2017)	27	*–*
	27	*–*

In addition to their fees, non-executive Directors are eligible for reimbursement of expenditure incurred for the attendance at Board meetings.

Following his retirement from EY on 30 June 2017, G Hughes has received Scheme Administrator's fees of £75,000 during the year ended 30 June 2018 (2017: £nil).

Neither B Cairns or K Gill received any remuneration in respect of their directorship of Municipal Mutual Insurance Limited.

11 Pensions

The Company operates a Workplace Pension Scheme which is an auto-enrolment compliant defined contribution scheme. Members of the scheme must contribute a minimum of 5% of gross salary, usually by way of salary sacrifice, with a further 4% of gross salary contributed to the Plan by the Company. Amounts shown in Note 9 in respect of staff and directors are the gross salaries to which they are entitled before deductions by way of salary sacrifice. Contributions made for death in service benefits for both executive directors and staff during the year amounted to £6,000 (2017: £5,000) and contributions for income protection benefits were £6,000 (2017: £nil).

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 30 JUNE 2018

12 Auditors' remuneration

	2018 £000	*2017 £000*
Fees payable to the Company's auditors for the audit of the Company	**152**	*150*
Audit related assurance and advisory services	**51**	*44*
	203	*194*

13 Tax on profit/(loss) on ordinary activities

The standard rate of Corporation Tax in the UK changed from 20% to 19% with effect from 1 April 2017. The relevant deferred tax balances have been calculated at this 19%.

	2018 £000	*2017 £000*
Profit on ordinary activities before tax	**1,432**	*4,379*
UK corporation tax at 19% (2017: 19.75%)		
Current tax on income for the period	**272**	*865*
Deferred tax on trading losses (utilised)	**(272)**	*(865)*
Tax charge in non-technical account	**–**	*–*

There is deferred tax not provided on tax losses of £11.8 million (2017: £12.0 million), which will be recovered if the Company makes future trading profits.

By agreement with the Inspector of Taxes, the Company has been treated as wholly non-mutual for tax purposes from 1993 onwards.

14 Other financial investments

Other financial investments comprise of the following

	2018		*2017*	
	Cost £000	Market Value £000	*Cost £000*	*Market Value £000*
Financial assets at fair value through the profit or loss	**236,137**	**237,625**	*247,758*	*251,119*

These investments comprise of UK Gilts and corporate bonds.

15 Tangible fixed assets

	Fixtures, fittings and office equipment £000
Book Cost	
At 1 July 2017	307
Additions	14
Disposals	–
At 30 June 2018	**321**
Accumulative depreciation	
At 1 July 2017	136
Charge for the year	63
Eliminations in respect of disposals	–
At 30 June 2018	**199**
Net book value	
30 June 2018	**122**
30 June 2017	171

The charge for depreciation for the year ended 30 June 2017 was £60,000.

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 30 JUNE 2018

16 Other creditors including taxation and social security

	2018 £000	*2017 £000*
Other creditors including taxation and social security	909	*824*
	909	*824*

17 Notes to the statement of cash flows

(i) Profit/(loss) on operating activities

	2018 £000	*2017 £000*
Profit for the financial year	1,432	*4,379*
Depreciation charges	63	*60*
Investment return	(4,701)	*(6,039)*
(Decrease) in gross claims provision	(16,808)	*(14,026)*
Decrease/(increase) in reinsurers' share of claims provision	800	*(1,000)*
Increase/(decrease) in other creditors	85	*(83)*
Decrease in amounts due from reinsurers	509	*178*
Decrease in debtors	818	*2,264*
Net cash (outflow) from operating activities	(17,802)	*(14,267)*

(ii) Movement in cash, portfolio investments and financing

	At 1 July 2017 £000	Cash flow £000	Changes to market value £000	At 30 June 2018 £000
Cash in hand and at bank and deposits with credit institutions	*3,179*	469	–	3,648
UK Gilts, debentures and floating rate notes	*251,119*	(11,384)	(2,110)	237,625
	254,298	(10,915)	(2,110)	241,273

18 Transactions with related parties

As Scheme Administrator, Gareth Hughes exercises general powers of management and control of the business. Prior to his retirement on 30 June 2017, Mr Hughes was a partner of Ernst and Young LLP. Kevin Gill was appointed a non-executive director of the Company on 31 October 2017 and is also a partner of Ernst and Young LLP. The Company has incurred the following costs in respect of services provided by Ernst & Young LLP.

	2018 £000	*2017 £000*
Administering the Scheme of Arrangement	110	*357*
Solvency II compliance support	5	*35*
Other assurance services	197	*–*
Taxation Services	19	*11*
	331	*403*

As at 30 June 2018, the balance outstanding in respect of these services was £30,000 (2017: £116,000).

19 Obligations under leases

Future minimum rentals payable under non-cancellable operating leases are as follows:

	Land and buildings 2018 £000	*Land and buildings 2017 £000*
Payable within one year	164	*164*
Payable between two and five years	24	*188*
	188	*352*

20 Contingent asset

The Company has been working with its lawyers in relation to the presentation and allocation of mesothelioma reinsurance claims in light of the Supreme Court ruling in Zurich Insurance PLC UK Branch v International Energy Group Limited. This process has included arbitration proceedings against one of the Company's reinsurers which resulted in a decision in favour of Municipal Mutual Insurance Limited in 2017. This decision is now subject to an appeal by the reinsurer in the Court of Appeal. If the Company is successful in relation to this dispute, and were it to apply this basis across all its reinsurers, it would have recognised an additional £26.8 million representing an estimate of the reinsurers' share of technical provision at 30 June 2018 (2017: £31.0 million).

21 Contingent liabilities

Upon the triggering of the Scheme of Arrangement the Scheme Administrator set an initial payment percentage of 85% and imposed an initial levy on Scheme Creditors of 15%. The payment percentage was decreased to 75% from 1 April 2016 and an additional 10% Levy was billed at that date. As at 30 June 2018, £190.3 million has been collected from Scheme Creditors via the Levy mechanism (2017: £188.3 million).

The Company reflects the requirement to repay this liability to the extent that it would otherwise hold surplus reserves. The future levy recoverable element of claims outstanding at 30 June 2018 of £78.7 million (2017: £87.2 million) includes an offset of £3.3 million (2017: £nil) in respect of these surplus reserves (see note 6(i)(b)).

Taking account of historical and future levy/payment percentage deductions, the liabilities of the Company have consequently been reduced by £269.0 million (2017: £275.5 million). Part, or all of these liabilities, could become payable to Scheme Creditors if the financial position of the company improves and the payment percentage is consequently increased.

Under the terms of the Scheme of Arrangement, Scheme Creditors are also entitled to additional payments of up to £30 million from any surplus reserves once all other liabilities have been met in full. This 'Commission for Risk' represents compensation to the Scheme Creditors for assuming the risk under the Scheme of having to make payments to the Company to satisfy the imposition of a Levy by the Scheme Administrator, or of having insurance claims payments reduced.

The Company has no other material contingent liabilities at 30 June 2018 (2017: £nil).

22 Ultimate controlling party

The Company is a company limited by guarantee and does not have a share capital. It is owned by its members. In accordance with Article IV (a) and (c) of the Company's Articles of Association, since the triggering of the Scheme of Arrangement the voting rights exercisable by the Scheme Administrator at general meetings give him effective overall control of the Company.

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