Equitable Life Assurance Society

Solvency and Financial Condition Report (SFCR)

31 December 2017
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APPENDIX 1: Quantitative Reporting Template Disclosures
<table>
<thead>
<tr>
<th>Abbreviation or Technical Term</th>
<th>Long Form / Explanation</th>
</tr>
</thead>
<tbody>
<tr>
<td>ALCo</td>
<td>Asset and Liability Committee</td>
</tr>
<tr>
<td>AMC(s)</td>
<td>Annual Management Charge(s)</td>
</tr>
<tr>
<td>APS X2</td>
<td>Review of Actuarial Work</td>
</tr>
<tr>
<td>ARC</td>
<td>Audit and Risk Committee</td>
</tr>
<tr>
<td>ASI</td>
<td>Aberdeen Standard Investments Limited</td>
</tr>
<tr>
<td>BACS</td>
<td>Bankers Automated Clearing Services run by Payments Schemes Limited</td>
</tr>
<tr>
<td>BAU</td>
<td>Business As Usual</td>
</tr>
<tr>
<td>CEF</td>
<td>Claims Enhancement Factor</td>
</tr>
<tr>
<td>CEO</td>
<td>Chief Executive Officer</td>
</tr>
<tr>
<td>CIUs</td>
<td>Collective Investments Undertakings</td>
</tr>
<tr>
<td>CMI</td>
<td>Continuous Mortality Investigation</td>
</tr>
<tr>
<td>COLL</td>
<td>Collective Investment Schemes Sourcebook</td>
</tr>
<tr>
<td>CRA</td>
<td>Credit Risk Adjustment</td>
</tr>
<tr>
<td>DDM</td>
<td>Dynamic Distribution Model</td>
</tr>
<tr>
<td>DFA</td>
<td>Dynamic Financial Analysis</td>
</tr>
<tr>
<td>EA</td>
<td>Excess Assets</td>
</tr>
<tr>
<td>EC</td>
<td>Economic Capital</td>
</tr>
<tr>
<td>ECAI</td>
<td>External Credit Assessment Institutions</td>
</tr>
<tr>
<td>ECD</td>
<td>Earliest Contractual Date</td>
</tr>
<tr>
<td>EIOPA</td>
<td>European Insurance and Occupational Pension Authority</td>
</tr>
<tr>
<td>EPEHL</td>
<td>Equitable Private Equity Holdings Ltd</td>
</tr>
<tr>
<td>ESG</td>
<td>Economic Scenario Generator</td>
</tr>
<tr>
<td>EU</td>
<td>European Union</td>
</tr>
<tr>
<td>Abbreviation</td>
<td>Full Form</td>
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<tr>
<td>--------------</td>
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<tr>
<td>EUC</td>
<td>End User Computing</td>
</tr>
<tr>
<td>ExCo</td>
<td>Executive Committee</td>
</tr>
<tr>
<td>FCA</td>
<td>Financial Conduct Authority</td>
</tr>
<tr>
<td>FRC</td>
<td>Financial Reporting Council</td>
</tr>
<tr>
<td>FRS102</td>
<td>Financial Reporting Standard - applicable in the UK and Republic of Ireland</td>
</tr>
<tr>
<td>Gilts</td>
<td>Gilt-edged securities are bonds issued by the British Government</td>
</tr>
<tr>
<td>GIR(s)</td>
<td>Guaranteed Investment Return(s)</td>
</tr>
<tr>
<td>KFH</td>
<td>Key Function Holder</td>
</tr>
<tr>
<td>KFP</td>
<td>Key Function Performer</td>
</tr>
<tr>
<td>KPI(s)</td>
<td>Key Performance Indicator(s)</td>
</tr>
<tr>
<td>KRD</td>
<td>Key Rate Duration</td>
</tr>
<tr>
<td>KRI</td>
<td>Key Risk Indicators</td>
</tr>
<tr>
<td>LBG</td>
<td>Lloyds Banking Group</td>
</tr>
<tr>
<td>LPI</td>
<td>Limited Price Indexation (relates to annuity products)</td>
</tr>
<tr>
<td>MCR</td>
<td>Minimum Capital Requirement</td>
</tr>
<tr>
<td>MI</td>
<td>Management Information</td>
</tr>
<tr>
<td>MLRO</td>
<td>Money Laundering Reporting Officer</td>
</tr>
<tr>
<td>NED</td>
<td>Non-Executive Director</td>
</tr>
<tr>
<td>OEIC</td>
<td>Open Ended Investment Company</td>
</tr>
<tr>
<td>OpsCo</td>
<td>Operations Committee</td>
</tr>
<tr>
<td>ORSA</td>
<td>Own Risk and Solvency Assessment</td>
</tr>
<tr>
<td>pa</td>
<td>per annum</td>
</tr>
<tr>
<td>PRA</td>
<td>Prudential Regulatory Authority</td>
</tr>
<tr>
<td>PwC</td>
<td>PricewaterhouseCoopers</td>
</tr>
<tr>
<td>RCSA</td>
<td>Risk and Control Self-Assessment</td>
</tr>
<tr>
<td>RM</td>
<td>Risk Margin</td>
</tr>
<tr>
<td>RSP</td>
<td>Recurrent Single Premium</td>
</tr>
<tr>
<td>SCR</td>
<td>Solvency Capital Requirement</td>
</tr>
<tr>
<td>-----</td>
<td>-----------------------------</td>
</tr>
<tr>
<td>Solvency II</td>
<td>European Union law that codifies and harmonises the EU insurance regulation. Primarily it concerns the amount of capital that EU insurance companies must hold to reduce the risk of insolvency. Came into effect from 1 January 2016.</td>
</tr>
<tr>
<td>TMTP</td>
<td>Transitional Measure on Technical Provisions</td>
</tr>
</tbody>
</table>
| UKCGC | United Kingdom Corporate Governance Code  
C.1: Accountability - Financial And Business Reporting  
C.2: Accountability - Risk Management and Internal Control  
C.3: Accountability - Audit Committee and Auditors |
| VA | Volatility Adjustment |
Directors’ Certificate

EQUITABLE LIFE ASSURANCE SOCIETY

Approval by the Board of Directors of the Solvency and Finance Condition Report for the period ending 31 December 2017

We certify that:

1. The Solvency and Financial Condition Report (SFCR) has been properly prepared in all material respects in accordance with the PRA rules and Solvency II Regulations; and

2. We are satisfied that:
   a. Throughout the financial year in question, the Society has complied in all material respects with the requirements of the PRA rules and Solvency II Regulations as applicable; and
   b. It is reasonable to believe that, at the date of the publication of the SFCR, the Society has continued so to comply, and will continue so to comply in future.

On behalf of the Board of the Equitable Life Assurance Society

Simon Small
Deputy Chief Executive and Finance Director
Audit Report

Report of the external independent auditors to the Directors of the Equitable Life Assurance Society ('the Company') pursuant to Rule 4.1 (2) of the External Audit Part of the PRA Rulebook applicable to Solvency II firms

Report on the Audit of the relevant elements of the Solvency and Financial Condition Report

Opinion

Except as stated below, we have audited the following documents prepared by the Company as at 31 December 2017:

- The ‘Valuation for solvency purposes’ and ‘Capital Management’ sections of the Solvency and Financial Condition Report of the Company as at 31 December 2017, (‘the Narrative Disclosures subject to audit’); and

- Company templates S.02.01.02, S.12.01.02, S.22.01.21, S.23.01.01, S.25.01.21 and S.28.01.01 (‘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:


- Company templates S.05.01.02;

- Information calculated in accordance with the previous regime used in the calculation of the transitional measure on technical provisions, and as a consequence all information relating to the transitional measure on technical provisions as set out in the Appendix to this report;

- The written acknowledgement by management 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.

In our opinion, the information subject to audit in the relevant elements of the Solvency and Financial Condition Report of the Company as at 31 December 2017 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.
**Basis for opinion**

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) including ISA (UK) 800 and ISA (UK) 805, and applicable law. Our responsibilities under those standards are further described in the *Auditors’ Responsibilities for the Audit of the relevant elements of the Solvency and Financial Condition Report* section of our report. We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the Solvency and Financial Condition Report in the UK, including the FRC’s Ethical Standard as applied to public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

**Conclusions relating to going concern**

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

- the Directors’ use of the going concern basis of accounting in the preparation of the Solvency and Financial Condition Report is not appropriate; or
- the Directors have not disclosed in the Solvency and Financial Condition Report 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 Solvency and Financial Condition Report is authorised for issue.

**Emphasis of Matter - Basis of Accounting**

We draw attention to the ‘Valuation for solvency purposes’ and ‘Capital Management’ sections of the Solvency and Financial Condition Report, which describe 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 Information**

The Directors are responsible for the Other Information.

Our opinion on the relevant elements of the Solvency and Financial Condition Report does not cover the Other Information and we do not express an audit opinion or any form of assurance conclusion thereon.

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

Responsibilities of Directors for the Solvency and Financial Condition Report

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, which have been supplemented by the approvals made by the PRA under section 138A of FSMA, the PRA Rules and Solvency II regulations on which they are based, as detailed below:

- Written notice 2234684 dated 13 November 2015 granting PRA approval to apply a volatility adjustment to the relevant risk-free interest rate term structure.
- Written notice 3253648 dated 24 November 2016 granting PRA approval to apply a transitional deduction to its technical provisions.

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.

Auditors’ Responsibilities for the Audit of the relevant elements of the Solvency and Financial Condition Report

It is our responsibility to form an independent opinion as to whether the information subject to audit in the relevant elements of the Solvency and Financial Condition Report is prepared, in all material respects, in accordance with financial reporting provisions of the PRA Rules and Solvency II regulations on which they are based.

Our objectives are to obtain reasonable assurance about whether the relevant elements of the Solvency and Financial Condition Report 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 it 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 decision making or the judgement of the users taken on the basis of the Solvency and Financial Condition Report.

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

This report, including the opinion, has been prepared for the Directors of the Company to comply with their obligations under External Audit rule 2.1 of the Solvency II firms Sector of the PRA Rulebook and for no other purpose. We do not, in providing this report, accept or assume responsibility for any other purpose save where expressly agreed by our prior consent in writing.
Report on Other Legal and Regulatory Requirements

In accordance with Rule 4.1 (3) of the External Audit Part 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 the Company’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.

PricewaterhouseCoopers LLP
Chartered Accountants
7 More London Riverside
London SE12RT
12 April 2018

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

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

- The following elements of template S.12.01.02
  - Rows R0110 to R0130 - Amount of transitional measure on technical provisions

- The following elements of template S.22.01.21
  - Column C0030 - Impact of transitional on technical provisions

- Elements of the Narrative Disclosures subject to audit identified as ‘unaudited’.
Chapter XII - Public Disclosure:

Section 1 - Solvency and financial condition report: Structure and contents

Article 290 - Structure

1. The solvency and financial condition report shall follow the structure set out in Annex XX and disclose the information referred to in Articles 292 to 298 of this Regulation.

2. The report shall contain narrative information in quantitative and qualitative form supplemented, where appropriate, with quantitative templates.

Article 291 - Materiality

For the purposes of this Chapter, the information to be disclosed in the solvency and financial condition report shall be considered as material if its omission or misstatement could influence the decision-making or the judgement of the users of that document, including the supervisory authorities.

Article 292 - Summary

1. The solvency and financial condition report shall include a clear and concise summary. The summary of the report shall be understandable to policy holders and beneficiaries.

2. The summary of the report shall highlight any material changes to the insurance or reinsurance undertaking's business and performance, system of governance, risk profile, valuation for solvency purposes and capital management over the reporting period.

Summary

Capital requirements and solvency coverage

The Society's Solvency II valuation has been undertaken to value Own Funds, including the application of an approved Transitional Measure on Technical Provisions (TMTP) of £100m.

The valuation of Own Funds and capital requirements for the Society, including TMTP, are summarised in the table below:

<table>
<thead>
<tr>
<th>£m</th>
<th>Position including VA</th>
<th>Position excluding VA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assets</td>
<td>6,613</td>
<td>6,613</td>
</tr>
<tr>
<td>Technical Provisions</td>
<td>5,851</td>
<td>5,890</td>
</tr>
<tr>
<td>Own Funds*</td>
<td>762</td>
<td>723</td>
</tr>
<tr>
<td>SCR</td>
<td>455</td>
<td>476</td>
</tr>
<tr>
<td>SCR coverage %</td>
<td>167%</td>
<td>152%</td>
</tr>
<tr>
<td>MCR</td>
<td>129</td>
<td>131</td>
</tr>
</tbody>
</table>
The corresponding results for the Society, excluding TMTP, are summarised below:

<table>
<thead>
<tr>
<th>£m</th>
<th>Position including VA</th>
<th>Position excluding VA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assets</td>
<td>6,613</td>
<td>6,613</td>
</tr>
<tr>
<td>Technical Provisions</td>
<td>5,952</td>
<td>5,991</td>
</tr>
<tr>
<td>Own Funds*</td>
<td>661</td>
<td>622</td>
</tr>
<tr>
<td>SCR</td>
<td>455</td>
<td>476</td>
</tr>
<tr>
<td>SCR coverage %</td>
<td>145%</td>
<td>131%</td>
</tr>
<tr>
<td>MCR</td>
<td>129</td>
<td>131</td>
</tr>
</tbody>
</table>

The Society has submitted an application for recalculated TMTP, which if approved would reduce Own Funds by c£30m. As approval has not yet been granted, the recalculation is not reflected in the results above or elsewhere in this report.

The Society complied with all Solvency II capital requirements throughout the current and prior year.

**Strategic report**

The Equitable Life Assurance Society is a mutual company owned by its Members. The Society no longer writes any new business and is therefore in run-off. We manage some £6bn of assets on behalf of: approximately 131,000 individual with-profits policyholders; 132,000 with-profits policyholders in company pension schemes; and 114,000 unit-linked policyholders.

The Society’s business model remains straightforward. The Society’s mission is exclusively to serve the best interests of our existing policyholders.

This report explains the Society’s strategy, linking it to the principal risks and our key performance indicators.

**The Society’s strategy — our next phase**

The Society’s aim is to recreate policyholder value by distributing all of the capital among with-profits policyholders as fairly and as soon as possible.

In last year’s report, we said that the Board is confident that it can deliver run-off with capital distribution most likely increasing gradually over time. Notwithstanding that, we would determine in 2017 whether there are means of materially mitigating the risk of any reduction in capital distribution, as well as identifying alternatives to run-off which could release capital earlier. We are in the final stages of evaluating alternative strategies.

In this section, we will explore in more depth what run-off could look like compared to the other options that the Board has considered.

The Society can maintain a solvent run-off for many years to come, with capital distribution most likely gradually increasing. Notwithstanding the success of the de-risking programme undertaken in the last five years, there remains one important risk that has yet to be fully mitigated: policyholders deferring retirement in a low interest rate environment. Some 80% of the Society’s with-profits policies have a built-in guarantee of 3.5% pa. Our assets are invested so that we can pay these guarantees based on when we estimate policyholders will
retire. When policyholders stay longer than expected, we have to reinvest the assets at a time when we cannot possibly hope to achieve a 3.5% return.

As a result, in run-off, we will have to hold back capital to provide for this risk. In addition, the solvency regulations require us to hold capital for events that are very unlikely to occur, leading to the gradual accumulation of capital. While the distribution of capital will likely increase over time, there could be years when it does not, or indeed periods where it may have to reduce. This may not meet our aim to distribute capital “as fairly and as soon as possible”.

The Board would need to consider how to deal with this accumulation of capital to prevent the unfair position of it being handed to those who happen to still hold policies in many years’ time. By then, it will cost far more, per policy, to run the Society than it does now as policy numbers reduce but fixed costs remain. One option would be to charge more for those who remain. Another option would be to try and sell the Society when it becomes uneconomic to run. However, much of the accumulated capital would need to be transferred to the acquirer to support the guarantees in the policies. Either way, policyholders are unlikely to see much, or any, of the capital in practice.

To summarise, run-off will probably be good for a period, with capital distribution gradually rising, but with a material risk that it does not. It is likely that the Society will become uneconomic to run and that the Board would need to establish at what price it could be sold, if at all, given the capital strain of the guarantees.

Our run-off strategy has succeeded in increasing capital distribution to 35% from nothing since 2011, by eliminating risks that required us to hold back capital. The material risk that continues is the existence of the policy guarantees. A new strategy designed to materially increase capital distribution would need to address the risks associated with the guarantees.

We have to hold back a very large amount of capital for the guarantees, yet, as a result of capital distribution, we estimate that approximately 96 out of 100 individual with-profits policyholders have a value in excess of their policy guarantee.

In the feasibility study, the Board is evaluating the following alternative strategies:

- Sale of the Society as it is constituted today. However, the Board has not received any enquiries from other companies and it is therefore uncertain whether there is a market, given the need to support the guarantees in the with-profits policies;

- Buying other closed books. At worst, this could put capital at risk with no guarantee that capital distribution could be accelerated. While this may extend the viable life of the Society, it would remain in run-off with its attendant risks;

- Reopening to new business. This would require capital to be held to support new generations, exacerbating the current inter-generational fairness issues;

- A major outsourcing. This may help mitigate the potential for the Society becoming uneconomic to run, depending on whether a contract for the full remaining life of the Society could be negotiated. It would not, however, resolve current issues over guarantees or the fairness of capital distribution;
• Liquidating the Society. It is legally challenging to wind up a solvent insurance company because policyholders would be left to find a new provider on their own. It would also give rise to material tax issues;

• Eliminating the risk in the guarantees in return for a significant uplift in policy values. This would very quickly return large amounts of capital to policyholders. The Board would need to ensure that policyholders felt they were being treated fairly and had a vote on such a material change to their contracts. Such a reduction in the risk profile may lead to interest from other companies in acquiring the Society. If such a transaction were to have the effect of increasing the amount of capital that could be distributed to policyholders, we would consider such a proposition very seriously; and

• Continuing in run-off. This option has already been described in some detail. In summary, it sets the bar for the other options to beat, which is by delivering capital back to policyholders gradually over time. In run-off, the Board may decide to adopt one or more of the options listed above, for example, a major outsourcing to mitigate the risks outlined above.

Investment values are at near record highs and we do not expect this to last forever. Any new strategy will need to ensure that these high values can be passed back to with-profits policyholders. Should interest rates rise, these asset values will fall, so in mitigation the Board has purchased derivatives called payer swaptions. These will rise in value as interest rates increase, offsetting to a very great extent the reduction in asset values.

Looking back on 2017
In these next sections, we highlight performance in 2017 against the key components of our strategy, focusing on solvency, investment and costs, along with the resulting impact on capital distribution.

Our approach to capital distribution
The Board is clear that, when policyholders leave, they should leave with a fair share of capital. The key here is that there should be proper balance between those policyholders who leave over the next few years and those who remain well beyond that. So long as there is sufficient capital to support the latter, earlier leavers should not be denied a fair capital distribution for the sake of higher investment returns to those policyholders who remain.

Every year, the Board assesses the impact of its risk reduction programme and decides whether an adjustment in capital distribution is warranted. To help inform the Board, extensive reviews of the capital required under a wide range of possible future economic conditions are undertaken. The most likely outcomes result in capital distribution rising over the next ten years, assuming policyholders continue the retirement patterns of the past.

However, policyholders are choosing to retire later and so remain with the Society past the retirement date we had been assuming. In a low interest rate environment, this increases the capital strain of the guarantees.
The following graph is indicative of the with-profits fund as a whole.

This phenomenon may be in consequence of any number of social or economic factors. It could be that:

- Policyholders are working for longer;
- Policyholders’ savings with the Equitable are a small part of their investment and are treated as ‘rainy day’ money;
- Relative returns on Equitable policies over recent years have been rather better than may have been expected;
- Policyholders expect further increases to capital distribution;
- Policyholders can bequeath their pension pots tax free if they die before age 75; and
- Policyholders believe they may be the beneficiaries of a windfall if they are the last remaining policyholders.

The potential for this trend to continue represents the most significant risk faced by the Society and is a profound impediment to returning capital to with-profits policyholders “as fairly and as soon as possible”. As previously discussed, it has been one of the principal reasons driving our strategic thinking.

Taking all these matters into consideration, the Board has decided that it is prudent and fair to maintain the current capital distribution of 35% for 2018.

**Carefully managing solvency**

Under the Solvency II regime, it is necessary to assess our capital using two different measures. The first measure, known as the Standard Formula, adopts a generic rules-based approach.

At the end of 2016, along with many other insurance companies, we successfully applied to the PRA for measures allowing us to smooth the impact of Solvency II under the Standard Formula measure. This has reduced the volatility seen in 2016, as shown in the graph below.
In addition to the Standard Formula measure, we also calculate solvency based on our view of the risks that directly impact the Society. We refer to this as ‘Management’s view’ of the capital required.

The reduction in volatility of solvency coverage has important implications for capital distribution. This is because the Board has defined a risk appetite such that the Society should hold capital at least 120% of that required in the two measures described above. Were the ratio to fall below 120%, capital distribution would likely be reduced. In arriving at the amount of capital we can distribute, we ensure that we have sufficient capital to cover both measures.

**Capital management**

The amount of capital we hold is the excess of assets over policy liabilities, known as Excess Assets. It has reduced by £43m since 2016 after allowing for capital distribution of £61m. In considering the future in a with-profits run-off, we believe that it is appropriate to provide for a number of costs that are likely to be incurred. For example, the cost of running an Irish subsidiary and the potential for renegotiating contracts when our buying power becomes less. This has contributed to the reduction in Excess Assets.

Management’s view of the amount of capital required is called Economic Capital. Here, we consider the impact on the Society’s capital under extreme conditions; events that could occur once in every 200 years resulting from, among other things, insurance risk, credit risk, market risk and operational risk. This measure has remained steady since 2016.

Accounting rules do not allow these extreme events to be included as liabilities in the Financial statements, but the capital required to support them is, nevertheless, the equivalent of non-distributable reserves. We are required to hold this Economic Capital to protect policyholders and, therefore, it has to be deducted from Excess Assets to arrive at the Surplus.

Excess Assets and Economic Capital interact as follows:

<table>
<thead>
<tr>
<th></th>
<th>Excess Assets</th>
<th>Economic Capital</th>
<th>Surplus</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>£m</td>
<td>£m</td>
<td></td>
</tr>
<tr>
<td>2017</td>
<td>901</td>
<td>(415)</td>
<td>486</td>
</tr>
<tr>
<td>2016</td>
<td>1,005</td>
<td>(423)</td>
<td>582</td>
</tr>
</tbody>
</table>

In the diagram, we see the solvency coverage over time, with both the Standard Formula and Management’s view compared against the required capital. The graph shows the percentage of solvency coverage, with the x-axis representing the months from December 2015 to December 2017.
The Surplus is the difference between the capital held and the capital required. When policyholders leave, they receive the capital distribution prevailing at the time. In 2017, this amounted to £61m which is funded by the Excess Assets.

**Investment return**

The Society’s investment strategy has been to effectively manage solvency and, only then, to maximise return. Key to this strategy is our policy of matching payments to cash flows from assets. This means that, as interest rates rise or fall, the Society’s ability to pay benefits is much less affected. In order to assess when policy payments will occur, judgement is required regarding future policyholder behaviour.

This strategy necessarily leads to a relatively conservative investment approach. The Society’s portfolio consists primarily of British government securities (gilts), corporate bonds, and cash. During the last few years, the Society has all but eliminated its holdings in capital intensive equities and property.

The investment return needs to be seen in context of increased capital distribution resulting from investing in relatively low risk assets. Consequently, the return is likely to be lower than from a portfolio invested in equities and property. However, and this is critical, capital distribution can be significantly higher.

The return on investments in 2017 was 1.0%. As a result of our matching policy and continuing low interest rates, the Society’s assets have risen by an equivalent amount to the increase in liabilities. Our matching policy requires us to hold the assets until maturity, to provide the necessary funds when policyholders decide to take their benefits. Consequently, the part of the return arising from the change in asset values caused by movements in interest rates cannot be passed on to policyholders. Therefore, it has been added back (0.8%) in order to arrive at the fund performance which, in 2017, was 1.8% before charges of 1.5%.

In considering an appropriate increase to policy values, we are informed more by the underlying long-term sustainable rate of return, secured when contributions were originally invested, than by the in-year performance. The underlying return is of the order of 2% pa after deduction of charges.

The Board has decided therefore that, for 2017, policy values will increase at 2% pa for UK with-profits pension policies (1.6% pa for life assurance policies where tax is deducted).

Interest rates have been low for many years. As a result, where policyholders postpone taking retirement benefits, we have to reinvest assets at the interest rates prevailing at the time. Therefore, if policyholders defer taking their benefits, the underlying rate of return of 2% is likely to become unsustainable at some point.

**Unit-linked business**

Following the significant changes we made to our unit-linked business in 2016, we concentrated on improving the customer experience and investment performance in 2017. The year saw the merger of Standard Life and Aberdeen Asset Management, who are our investment managers for the unit-linked business. We have worked in partnership to realise an improvement in performance over the year with many asset classes experiencing all-time highs.
We have also improved our website and listened to the policyholders who asked for a more regular update on their funds. As a result, we now communicate twice a year with policyholders and include the fund value.

**Providing the best value-for-money cost base**

In the past, we have considered value for money to be where administrative expenses reduce in line with the run-off of policies as policyholders take their benefits. During 2017, the reduction in policies was approximately 25,000; a 7% fall over 2016. Administrative expenses fell by c9% from £24m to £22m.

We also incur costs through the need for one-off projects. Success for such spend is to reap the benefits of the projects, which are often critical to enabling capital distribution.

Reducing administrative expenses in line with policy run-off requires efficiency savings to be made, which more than mitigate upward pressures on the cost base such as inflation. In any given year, it is not always possible to achieve this due to, for example, the exit of a group pension scheme.

However, over time, the associated costs are managed downwards. As the table below shows, we have been able to reduce expenses faster than policy numbers.

<table>
<thead>
<tr>
<th>% reduction between 2009 and 2017</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Administrative expenses</td>
<td>46</td>
</tr>
<tr>
<td>Policy numbers</td>
<td>44</td>
</tr>
</tbody>
</table>

The main areas of saving continue to be from the Lean Manufacturing techniques first introduced in 2011, and the Society’s cost reduction programme known as Simplification. Lean Manufacturing promotes continuous improvement and operational excellence within the business.

The Simplification programme has succeeded in reducing costs by an annualised £1.7m, in addition to the £5.6m announced last year. This has been achieved by renegotiating third-party contracts, reducing the VAT on investment charges and migrating to more efficient IT platforms. Staff numbers, including contractors, fell from 242 in December 2016 to 237 by the end of 2017.

Total costs in 2017 have remained steady at £37m, down from £115m in 2009.

In setting targets to deliver a value-for-money cost base, the Board is mindful of the need to have in place strong controls. In this respect, the Society operates a robust and
comprehensive Risk Management Framework. Service to policyholders is monitored very regularly and, throughout 2017, we have performed within the standards agreed by the Board.

The Society currently levies a charge of 1% pa on with-profits assets to cover the costs of running the business. Our Lean Manufacturing and Simplification work has been fundamental to keeping costs within that 1% in recent years.

In run-off, it is unlikely that we could run the business within the 1% charge beyond the next ten years. The main opportunities for cost reduction have been taken and, at some point, the cost per policy will rise as policy numbers fall and fixed costs remain.

Indeed, we are recognising now, in our liabilities, some extra costs that are likely to be necessary in the future. For example, in order to continue to service the Irish and German business following the UK’s exit from the European Union, it will be necessary to establish a subsidiary in Dublin and ‘Passport’ to Germany.

The perspective of policyholders
We place great store on what policyholders think. Every year, we seek the views of a representative sample of policyholders through questionnaires and discussion groups.

In our most recent survey, it is very pleasing to know that almost all policyholders who had engaged with our staff felt that they had responded positively.

This confirms our view that staff take great pride in providing a trusted and valued service.

Key performance indicators
Key performance indicators are used by the Board to show the extent to which the strategies designed to recreate policyholder value are achieving the desired outcome. The most important indicators are shown in the table below.

<table>
<thead>
<tr>
<th>% of policy value</th>
<th>2015-18</th>
<th>2014</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital distribution</td>
<td>35</td>
<td>25</td>
<td>12.5</td>
</tr>
<tr>
<td>Policy value increase</td>
<td>2</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>Financial Adjustment</td>
<td>0</td>
<td>0</td>
<td>5</td>
</tr>
</tbody>
</table>

The Board’s strategy of capital distribution has clearly led to increases in policyholder value.

Principal risks
The Society operates a comprehensive Risk Management Framework through which it identifies, monitors and reports on the principal risks to its strategic objectives. They are managed within a risk appetite set by the Board, who ensure that adequate capital is then held against these risks.

Simply stated, the more risk the Society takes in managing its business, the more capital it needs to hold in case things go wrong. Hence, the Board’s focus on reducing these risks.
While individual risks are important, the Board also considers certain combinations of risks. This is particularly relevant in turbulent market conditions. For example, falling interest rates combined with policyholders deferring benefits is a particularly onerous combination. If these risks were to materialise in an economic environment of credit defaults and a divergence of swap and gilt yields, then this would put at risk the current level of capital distribution.

The main risks relevant to the Society are described below.

**Insurance risk**
Insurance risk refers to fluctuations in the timing, frequency and severity of insured events relative to the expectations of the Society at the time of underwriting.

The most material insurance risk is in regard to retirements and transfers not being in line with estimates. To help mitigate this risk, the Society holds a series of derivatives called receiver swaptions. When interest rates reduce, the value of the swaptions rises, offsetting the increase in policy liabilities that might arise as a result of policyholders deferring retirement. When interest rates rise, the value of the swaptions will fall but will be offset by a reduction in policy liabilities, leading to minimal change in overall Surplus.

The second material insurance risk is in regard to expenses not reducing in line with policyholder run-off. The risk reduced during 2017, following the success of the Society’s Simplification programme.

**Liquidity risk**
This is the risk that the Society is unable to meet short-term cash flow requirements, particularly those in respect of policyholders taking their benefits.

The Society has held high levels of liquid assets in order to provide protection against the scenario of policyholders who have passed their earliest contractual date deciding to take their benefits immediately.

**Credit risk**
Credit risk refers to where a counterparty fails to pay amounts in full when due. The main credit risks faced by the Society are:

(i) The risk of default on its portfolio of fixed-interest securities, especially corporate bonds; and
(ii) The risk of default by any of its reinsurers.

The Society seeks to limit exposure to credit risk by setting robust selection criteria and exposure limits covering factors such as counterparty financial strength. The Society monitors performance so that appropriate management actions can be taken to pre-empt loss from default events. No defaults occurred in 2017.

The major reinsurance treaties totalling c£0.4bn are with Scottish Widows, part of the Lloyds Banking Group.

**Market risk**
(i) Interest rates: the risk that interest rate changes have a financial impact through any mismatching of assets and liabilities. The Society closely matches the expected income from assets to the expected outgoings from policy maturities. The more closely we are matched, the less capital is required against interest rate movements.
During 2017, there were two adjustments to asset duration following the year-end and half-year liability valuations. The adjustments had the impact of further strengthening cash flow matching.

As outlined above, should interest rates rise the asset values will fall, so limiting the Society’s strategic options. In mitigation, the Board authorised in 2017 the purchase of payer swaptions.

(ii) Spread risk: changes in the value of corporate bonds relative to gilts could have a financial impact on our capital calculations. The Society invests in a diversified portfolio of high-quality corporate bonds, thereby reducing the potential exposure.

(iii) Swap basis risk: Solvency II requires liabilities to be valued using swap rates, whereas our assets are primarily gilts and bonds. We have accepted this risk and do not hedge against it.

Operational risk
Operational risk is the potential for loss to result from inadequate or failed internal processes and systems, human error or from external events. The main sources of operational risk for the Society are:

1. Those related to delivery of services to our policyholders;
2. The delivery of services to the Society by significant third-party suppliers; and
3. Risks in executing strategic projects.

The management controls designed to mitigate these risks have succeeded in keeping losses to a bare minimum. There have been no material changes to operational risk in the year.

Having said that, cyber attacks on companies are a growing threat. These could lead to loss of policyholder data, operational disruption, and reputational damage. Working closely with suppliers, the Board regularly assesses the threat level in the UK, along with the Society’s defences against various potential attacks. Management also conducts simulations to ensure that the Society is as prepared as it can be.

Regulatory risk
Regulatory risk is the risk to capital and reputation associated with a failure to identify or comply with regulatory requirements and expectations. We put great store in having an open and cooperative relationship so that our regulators fully understand our strategy, any changes to it and how we are performing against our objectives. We have arrangements in place to identify new regulatory developments, implement changes to meet these requirements, and monitor ongoing compliance.

Conclusion
Whatever the outcome of our strategic analysis, the Board is confident that it can continue to re-create policyholder value for you, our with-profits policyholders.
A. Article 293 - Business and Performance

A.1 Business

1. The solvency and financial condition report shall include all of the following information regarding the business of the insurance or reinsurance undertaking:

(a) the name and legal form of the undertaking;
(b) the name and contact details of the supervisory authority responsible for financial supervision of the undertaking and, where applicable, the name and contact details of the group supervisor of the group to which the undertaking belongs;
(c) the name and contact details of the external auditor of the undertaking;
(d) a description of the holders of qualifying holdings in the undertaking;
(e) where the undertaking belongs to a group, details of the undertaking's position within the legal structure of the group;
(f) the undertaking's material lines of business and material geographical areas where it carries out business;
(g) any significant business or other events that have occurred over the reporting period that have had a material impact on the undertaking.

Guideline 1 - Business

1.13. Under section “A.1 Business” of the SFCR as defined in Annex XX of the Delegated Regulation, insurance and reinsurance undertakings should describe at least the following information regarding their business:

a) The name and location of the legal or the natural persons that are direct and indirect holders of qualifying holdings in the undertaking (including the immediate and ultimate parent entity or natural person), the proportion of ownership interest held and, if different, the proportion of voting rights held;

b) A list of material related undertakings including the name, legal form, country, proportion of ownership interest held and, if different, proportion of voting rights held;

c) A simplified group structure.

A.1 Business

(a) The Equitable Life Assurance Society is a mutual society registered in England No. 37038. Registered office and administrative Office: Walton Street, Aylesbury, Buckinghamshire, HP21 7QW

(b) The Society is authorised and regulated by the Prudential Regulation Authority (PRA) as a Category 3 firm and regulated for conduct by the Financial Conduct Authority (FCA) as a “flexible portfolio” firm. The Society complies with all relevant requirements of PRA and FCA as set out in their respective Rulebook and Handbook.

The Society’s PRA contact is:

Senior Supervisor
Retail Life Supervision
Prudential Regulation Authority
Bank of England
London
EC2R 8AH
Phone - +44 (0)20 3461 7654
The Society’s FCA contact is

Pensions & Retirement Income / Life Insurance and Financial Advice
Supervision - Investments, Wholesale and Specialists Division
Financial Conduct Authority
25 The North Colonnade
Canary Wharf
London
E14 5HS

Phone - 020 7066 1514

(c) Auditors: PricewaterhouseCoopers LLP, 7 More London Riverside, London, SE1 2RT

(d) The Society is a mutual organisation owned by its members, with only one tier of capital, namely policyholders’ funds. No other sources of additional capital are currently available.

(e) The Society’s only subsidiary, Equitable Private Equity Holdings Ltd was liquidated in 2017, with final dissolution and removal from the Guernsey Register of Companies on 19 March 2018. The underlying investment, the Knightsbridge V Limited Partnership is now held directly by ELAS at net asset value.

(f) The principal activity of the Society during 2017 remained the transaction of life assurance and pension business in the form of guaranteed, participating and unit-linked contracts, predominantly in the UK. The Society closed to new business on 8 December 2000.

Operations are focused on the administration of c200,000 individual policies and c150,000 members of company pension schemes, comprising c£6.5bn of policyholder liabilities. Policies are running off at a rate of approximately 35,000 per annum and the vast majority of members are expected to take their benefits over the next 20 years.

(g) There were are no significant business or other events in 2017 to report.

A.2 Underwriting Performance

The solvency and financial condition report shall include qualitative and quantitative information on the insurance or reinsurance undertaking's underwriting performance, at an aggregate level and by material line of business and material geographical areas where it carries out business over the reporting period, together with a comparison of the information with that reported on the previous reporting period, as shown in the undertaking’s financial statements.

The Society closed to new business in December 2000. Therefore underwriting performance is no longer considered of material relevance to the Society.
Movement in Excess Assets
The principal movements in the Excess Assets during the year are shown in the following table.

<table>
<thead>
<tr>
<th>Key movements</th>
<th>2017 £m</th>
<th>2016 £m</th>
</tr>
</thead>
<tbody>
<tr>
<td>Opening Excess Assets</td>
<td>1,005</td>
<td>793</td>
</tr>
<tr>
<td>Investment performance net of changes in policy values</td>
<td>(22)</td>
<td>173</td>
</tr>
<tr>
<td>Variance in expenses experience and assumptions</td>
<td>(31)</td>
<td>51</td>
</tr>
<tr>
<td>Changes in valuation experience and assumptions</td>
<td>2</td>
<td>86</td>
</tr>
<tr>
<td>Capital distribution within claims payments</td>
<td>(61)</td>
<td>(93)</td>
</tr>
<tr>
<td>Other movements</td>
<td>8</td>
<td>(5)</td>
</tr>
<tr>
<td>Closing Excess Assets</td>
<td>901</td>
<td>1,005</td>
</tr>
</tbody>
</table>

Premiums and Claims

<table>
<thead>
<tr>
<th></th>
<th>2017 £m</th>
<th>2016 £m</th>
</tr>
</thead>
<tbody>
<tr>
<td>Earned premiums, net of reinsurance</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gross premiums written</td>
<td>11</td>
<td>1</td>
</tr>
<tr>
<td>Other outward reinsurance premiums</td>
<td>(7)</td>
<td>(5)</td>
</tr>
<tr>
<td>Claims incurred, net of reinsurance</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Claims paid – gross amount</td>
<td>364</td>
<td>498</td>
</tr>
<tr>
<td>Reinsurers’ share</td>
<td>(21)</td>
<td>(29)</td>
</tr>
<tr>
<td></td>
<td>343</td>
<td>469</td>
</tr>
</tbody>
</table>

A.3 Investment Performance

The solvency and financial condition report shall include all of the following qualitative and quantitative information regarding the performance of the investments of the insurance or reinsurance undertaking over the reporting period together with a comparison of the information with that reported on the previous reporting period, as shown in that undertaking’s financial statements:

(a) information on income and expenses arising from investments by asset class and, where necessary for a proper understanding of the income and expenses, the components of such income and expenses;

(b) information about any gains and losses recognised directly in equity;

(c) information about any investments in securitisation.
A.3 Investment Performance

a) The table below shows investment performance during the year ended 31 December 2017

**INVESTMENT PERFORMANCE**

<table>
<thead>
<tr>
<th></th>
<th>At 31 December 2017</th>
<th>£m</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Realised gains</td>
<td>Unrealised gains</td>
</tr>
<tr>
<td><strong>Fixed income securities</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Government bonds</td>
<td>43.1</td>
<td>(53.4)</td>
</tr>
<tr>
<td>Index linked</td>
<td>24.4</td>
<td>(18.3)</td>
</tr>
<tr>
<td>Other fixed interest</td>
<td>(5.5)</td>
<td>(15.7)</td>
</tr>
<tr>
<td></td>
<td>62.0</td>
<td>(87.4)</td>
</tr>
<tr>
<td><strong>Other Investments</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Property &amp; Equity</td>
<td>(11.9)</td>
<td>11.7</td>
</tr>
<tr>
<td>Derivatives</td>
<td>(7.0)</td>
<td>(38.7)</td>
</tr>
<tr>
<td></td>
<td>(18.9)</td>
<td>(27.0)</td>
</tr>
<tr>
<td><strong>Unit linked funds</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Property &amp; Equity</td>
<td>4.6</td>
<td>6.5</td>
</tr>
<tr>
<td>Collective Invt Undertakings</td>
<td>31.0</td>
<td>137.5</td>
</tr>
<tr>
<td>Derivatives</td>
<td>3.2</td>
<td>(1.0)</td>
</tr>
<tr>
<td></td>
<td>38.8</td>
<td>143.0</td>
</tr>
<tr>
<td><strong>Interest</strong></td>
<td>0.3</td>
<td>(0.4)</td>
</tr>
<tr>
<td><strong>Other</strong></td>
<td>1.8</td>
<td>(2.1)</td>
</tr>
</tbody>
</table>

**TOTAL ASSETS**

84.0 26.1 154.5 (4.8) 259.8
### Investments - At 31 December 2016

<table>
<thead>
<tr>
<th></th>
<th>Realised gains</th>
<th>Unrealised gains</th>
<th>Investment income</th>
<th>Investment expenses</th>
<th>TOTAL RETURN</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Fixed income</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Securities</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Government bonds</td>
<td>49.4</td>
<td>122.2</td>
<td>92.5</td>
<td></td>
<td>264.1</td>
</tr>
<tr>
<td>Index linked</td>
<td>61.4</td>
<td>1.9</td>
<td>5.2</td>
<td></td>
<td>68.5</td>
</tr>
<tr>
<td>Other fixed interest</td>
<td>18.3</td>
<td>2.4</td>
<td>46.9</td>
<td></td>
<td>67.6</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>129.1</td>
<td>126.5</td>
<td>144.6</td>
<td></td>
<td>400.2</td>
</tr>
<tr>
<td><strong>Other Investments</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Property &amp; Equity</td>
<td>(11.9)</td>
<td>13.8</td>
<td>-</td>
<td></td>
<td>1.9</td>
</tr>
<tr>
<td>Derivatives</td>
<td>110.8</td>
<td>(14.9)</td>
<td>-</td>
<td></td>
<td>95.9</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>98.9</td>
<td>(1.1)</td>
<td>-</td>
<td></td>
<td>97.8</td>
</tr>
<tr>
<td><strong>Unit linked funds</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Property &amp; Equity</td>
<td>2.4</td>
<td>33.3</td>
<td>-</td>
<td></td>
<td>35.7</td>
</tr>
<tr>
<td>Collective investment undertakings</td>
<td>(21.1)</td>
<td>224.1</td>
<td>33.3</td>
<td>236.3</td>
<td></td>
</tr>
<tr>
<td>Derivatives</td>
<td>(0.1)</td>
<td>-</td>
<td>-</td>
<td></td>
<td>(0.1)</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>(18.8)</td>
<td>257.4</td>
<td>33.3</td>
<td></td>
<td>271.9</td>
</tr>
<tr>
<td><strong>Interest</strong></td>
<td>1.1</td>
<td>0.1</td>
<td>2.2</td>
<td></td>
<td>3.4</td>
</tr>
<tr>
<td><strong>Other</strong></td>
<td>0.8</td>
<td>3.4</td>
<td>(0.5)</td>
<td>(6.2)</td>
<td>(2.5)</td>
</tr>
<tr>
<td><strong>TOTAL ASSETS</strong></td>
<td>211.1</td>
<td>386.3</td>
<td>179.6</td>
<td>(6.2)</td>
<td>770.8</td>
</tr>
</tbody>
</table>

Fixed income investment returns are significantly lower than in 2016 reflecting yields that, while volatile during the year, started and ended at a similar level. By comparison, low yields in 2016 resulted in a high investment return.

The loss on payer and receiver swaption derivatives in 2017 reflects the unwinding of time value, the increase in interest rates in the autumn and low expectations of interest rate volatility in the future. In 2016 the receiver swaption portfolio was re-struck, crystallising a £95m of gain, taking advantage of the low interest rate environment.

Investments held to cover unit linked liabilities are mostly equity based collective investment undertakings. In both 2017 and 2016, gains on these assets reflect a rise in equity based investments over the year.

(b) The Society does not recognise any gains or losses directly in equity

(c) The Society does not hold investments in securitisation (for example, asset backed securities).
A.4 Performance of other activities

The solvency and financial condition report shall describe the other material income and expenses of the insurance or reinsurance undertaking incurred over the reporting period together with a comparison of the information with that reported on the previous reporting period, as shown in that undertaking’s financial statements.

Guideline 2 - Performance of other activities

1.14. Under section A.4. Performance of other activities” of the SFCR as defined in Annex XX of the Delegated Regulation, insurance and reinsurance undertakings should describe in general the leasing arrangements in relation to each material leasing arrangement, separately for financial and operating leases.

A.4 Performance of other activities

Net operating expenses

<table>
<thead>
<tr>
<th></th>
<th>2017</th>
<th>2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>Administration expenses</td>
<td>22</td>
<td>24</td>
</tr>
<tr>
<td>Costs of strategic initiatives</td>
<td>9</td>
<td>4</td>
</tr>
<tr>
<td>Redundancies</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td><strong>Total net operating expenses</strong></td>
<td>31</td>
<td>29</td>
</tr>
<tr>
<td>Investment management expenses</td>
<td>5</td>
<td>6</td>
</tr>
<tr>
<td>Claims handling expenses</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td><strong>Total costs</strong></td>
<td>37</td>
<td>37</td>
</tr>
</tbody>
</table>

Administration expenses have fallen in 2017 as a result of efficiency savings from fewer staff and smaller office space. Administration expenses include lease costs of less than £1m (2016: <£1m). Costs of strategic initiatives include those associated with assessing the feasibility of a change to strategy. Investment management costs have fallen in 2017 due to reduced charges on cash funds. The decrease in claims handling expenses was driven by the reduction in administration costs and the lower level of claims experienced in 2017.

Other technical income and charges

Other technical income of £4m (2016: £6m) includes rebates received from unit-linked Open Ended Investment Company (OEIC) fund managers of £3m (2016: £5m)

There were no Other technical charges in 2017. Other technical charges in 2016 included £27m for the transfer of unit-linked annuities, that were not part of the reinsurance arrangement, to Canada Life, and £30m investment loss on assets over which Canada Life held a secured charge.

A.5 Any other information

The solvency and financial condition report shall include in a separate section any other material information regarding their business and performance of the insurance or reinsurance undertaking.

A.5 Any other information

At this time there is no other material information to disclose.
B. Article 294 - System of Governance

B.1 General information on the system of governance

The solvency and financial condition report shall include all of the following information regarding the system of governance of the insurance or reinsurance undertaking:

(a) the structure of the undertaking’s administrative, management or supervisory body, providing a description of its main roles and responsibilities and a brief description of the segregation of responsibilities within these bodies, in particular whether relevant committees exist within them, as well as a description of the main roles and responsibilities of key functions;

(b) any material changes in the system of governance that have taken place over the reporting period;

(c) information on the remuneration policy and practices regarding administrative, management or supervisory body and, unless otherwise stated, employees, including:

(i) principles of the remuneration policy, with an explanation of the relative importance of the fixed and variable components of remuneration;

(ii) information on the individual and collective performance criteria on which any entitlement to share options, shares or variable components of remuneration is based;

(iii) a description of the main characteristics of supplementary pension or early retirement schemes for the members of the administrative, management or supervisory body and other key function holders;

(d) information about material transactions during the reporting period with shareholders, with persons who exercise a significant influence on the undertaking, and with members of the administrative, management or supervisory body.

Guideline 3 - Governance Structure

1.15. Under section “B.1. General information on the system of governance” of the SFCR as defined in Annex XX of the Delegated Regulation, insurance and reinsurance undertakings should explain how the key functions have the necessary authority, resources and operational independence to carry out their tasks and how they report to and advise the administrative, management or supervisory body of the insurance or reinsurance undertaking (hereinafter “AMSB”).

B.1 General Information on the system of governance -

(a) The Society aims to meet the highest standards in corporate governance and voluntarily adopts the relevant provisions of the 2016 UK Corporate Governance Code (UKCGC). The Board is responsible to the Society’s members for good corporate governance and applies high standards to ensure that this is achieved.

Key to membership of principal Board Committees

(a) Audit and Risk

(b) Remuneration

(c) Nominations
The Board of Directors

Ian Brimecome (b) (c) - Chairman
Keith Nicholson (a) (b) (c) - Deputy Chair and Senior Independent Director
Chris Wascarson - Chief Executive (CEO)
Simon Small - Deputy Chief Executive and Finance Director
Penny Avis (a)
Lord Finkelstein (b)
Ian Gibson (a)
Cathryn Riley (a) (b) (c)

In 2017 there were 7 Board meetings, 7 With-Profits Committee, 6 Audit & Risk Committee, 3 Nominations Committee and 4 Remuneration Committee meetings held. In addition to these, there were a further 7 meetings attended by Directors to consider strategic proposals and five further meetings of the With-Profits sub-Committee.

The Board
The Board meets regularly to lead, control and monitor the overall performance of the Society. The Board’s principal functions are: to determine the strategy and policies of the Society; to set out guidelines within which the business is managed; and to review business performance. The Board considers and decides on all major matters of Society corporate strategy and ensures that the strategy is consistent with its appetite for risk. There is a formal schedule of matters reserved for the Board’s decision. Members of senior management supply the Board with appropriate and timely information and are available to attend meetings and answer questions. Authority is delegated to the Chief Executive (CEO) for implementing strategy and managing the Society.

The roles of Chairman and Chief Executive (CEO) are separated and the Chairman has primary responsibility for the effective functioning of the Board.

Management of the Society
The Executive team structure was changed in February 2018 to better meet the needs of the business.

The Executive team meets weekly to manage business activities. Papers are prepared and presented to the Board and its Committees by the Executive team. The Executive team comprises: the Chief Executive; the Deputy Chief Executive and Finance Director; the Risk Director; the Chief Actuary; the Chief Operating Officer; the Customer Service Director; and the Company Secretary.

The Chief Actuary, advises on the Society’s ability to meet obligations to policyholders. He identifies and assesses the risks that could have a material impact on meeting these objectives as well as the capital needed to support the business. He also advises the Board on the methods and assumptions to be used for the assessment of the value of the Society’s liabilities, and reports on the results. The Society is also required to appoint a With-Profits Actuary, who advises the Board on key aspects of the discretion to be exercised affecting with-profits business, including the fair treatment of and communication with with-profits policyholders, and advice on bonus rates.

The Board has responsibility for investment strategy, investment policy and appointing investment managers. These responsibilities are discharged through the Society’s Asset and Liability Committee (ALCo), which is chaired by the Deputy Chief Executive and Finance Director. The Committee takes advice from the Chief Actuary and the Chief Investment
Officer, and regularly liaises with the investment advisers to oversee day-to-day investment matters.

The Deputy Chief Executive and Finance Director is the executive responsible for: the Society’s Finance, IT Change, HR and Investment functions; and our unit-linked business. He is also responsible for corporate strategy development and monitors progress against targets.

Monthly management information (MI) in respect of financial performance, fair treatment of policyholders, complaints handling, risk management, compliance and investment performance is prepared and reviewed by senior management, the Executive team and the Board.

Each year, the Society prepares a business plan and budget to assist in the monitoring of results, assets, liabilities and investment performance. Actual performance against these plans is actively monitored and, where appropriate, corrective action is agreed and implemented.

The Chief Operating Officer is responsible for overseeing delivery of the Society’s strategy by ensuring appropriate infrastructure and resources are in place while complying with regulatory and legislative requirements.

The Customer Service Director is responsible for ensuring that we meet the day-to-day needs of the policyholders.

The Risk Director is responsible for: providing the framework of risk policies; processes and approaches to be followed by staff; and for reporting to the Audit Risk Committee (ARC) and the Board on the key risks facing the Society and how those risks are controlled and managed.

The Company Secretary is responsible for the proper functioning of Board, Board Committees and Executive Committees; overseeing the Society’s governance arrangements; advising the Board on corporate governance matters.

Board Committees
The Board formally delegates certain specific responsibilities to the four Board Committees.

Audit Risk Committee (ARC)
The objectives of the Committee are to assist the Board in ensuring that:

With regard to audit matters:

- The accounting systems provide accurate and up to date information on the financial position of the Society, and that the published Annual Report and Accounts represents a true and fair reflection of this position and that regulatory information is on a properly prepared basis.
- Appropriate accounting policies and systems of internal control are in place for the Society, taking account of those internal controls and other activities carried out by third parties in relation to their provision of services to the Society.
- The Society meets, in all material respects, the provisions relating to Principles C1, C2 and C3 of The UK Corporate Governance Code appended to the Listing Rules of the Financial Conduct Authority and the Guidance on Audit Committees, except where the Board does not consider that the guidance is appropriate or relevant to the Society.
The Society complies with the Financial Services and Markets Act 2000 and Money Laundering Regulations.

With regard to risk matters:

- The risk appetite is appropriate for the Society’s needs.
- Key risks are identified and managed.

**NOMINATIONS COMMITTEE**

The objectives of the Committee are:

- To assist the Board in ensuring that the Board has a mix of Directors with the necessary skills, experience and independence to govern the Society effectively;
- To assist the Board in ensuring that suitable candidates are identified to fill vacancies or to add to the strength of the Society’s Board;
- To review, on an ongoing basis, the appropriateness and suitability of each Director for continuing membership of the Board taking into account regulatory requirements and good corporate governance practices; and  
- To assist the Board to meet, wherever possible, the standards set out in the UK Corporate Governance Code published by the Financial Reporting Council (FRC), in relation to membership of the Board.

**REMUNERATION COMMITTEE**

The objectives of the Committee are to assist the Board in ensuring that:

- The overall terms and conditions of employment of all Directors (including Executive Directors) are satisfactory; and
- Remuneration policy and practice for the Society complies with the remuneration requirements of Articles 275 of the Solvency II regulations and with the European Insurance and Occupational Pensions Authority (EIOPA) ‘Guidance on system of governance’ finalised on 14 September 2015, and wherever possible, meets the standards set out in the UK Corporate Governance Code published by the Financial Reporting Council (FRC).

**WITH PROFITS COMMITTEE**

The Committee considers matters affecting with-profits policyholders such that the interests of all, or, where relevant, specific groups of, policyholders are appropriately considered. Its primary objective is to ensure the fair treatment of with-profits policies, having due regard to:

- Appropriate risk and capital management;
- Fair payout’s when benefits are taken;
- Appropriate investment strategies for the Society’s fund;
- Clear and timely policyholder communications; and
- Any issues that with-profits policyholders might reasonably expect the Committee to consider.

The Committee works closely with, and obtains the opinion and advice of, the Society's With-Profits Actuary. In 2017, the Board carried out the duties of the With-Profits Committee. In order to ensure appropriate focus is given to these duties, the With-Profits Committee meets as part of Board Meetings at which there are with-profits items.
B.1 (b)
On behalf of the Board, the ARC has reviewed the effectiveness of the risk management and internal control systems for the year ended 31 December 2017.

The review demonstrated that the Society has in place a comprehensive set of risk management and internal control arrangements. These include the identification, assessment, measurement, monitoring, reporting and management of risks. The review also confirmed that the Society is compliant with the Systems of Governance requirements under Solvency II. There have been no material changes to the Society’s Systems of Governance in 2017.

B.1 (c) (i)
The purpose of the Remuneration Policy is to ensure that staff are appropriately incentivised to meet the objectives of the business. The policy is set by the Board, having been recommended by the Remuneration Committee. Executive Director remuneration is set and reviewed by the Remuneration Committee. The Committee reviews and approves, if thought fit, recommendations from the Chief Executive (CEO) regarding the remuneration of the Senior Management Team. Employee remuneration is monitored, and changes are approved by the Executive Committee (ExCo).

As well as salary, pension and other benefits, staff have the opportunity to receive a discretionary annual bonus.

All staff benefit from life assurance cover. The Society pays the medical, permanent health and life insurance premiums on behalf of certain staff. Eligible staff are automatically enrolled into a workplace pension scheme, the Equitable Life Grouped Personal Pension Plan with Legal & General.

During 2017, the Committee focused on ensuring that executive remuneration aligns with, and supports, delivery of a new strategy. There is great benefit for policyholders in retaining the skill, knowledge and commitment of the executive Directors through to successful completion of our plans. Any change to the Executive team could be disruptive and potentially delay delivery. This would be highly detrimental to policyholders.

In the remuneration policy approved by members in 2016, we included provision for a bonus payable in the event of a corporate transaction. As our strategy work develops, it is clear that this would be an important part of the remuneration package. In particular, it was agreed to introduce a retention payment arrangement for Mr Small given his prime role in the implementation of any new strategy. A bonus of twice Mr Small’s base salary has been put in place payable on the earlier of successful completion of such new strategy or 31 December 2020.

Mr Wiscarson has advised the Committee that he does not want a retention payment to be put in place. Given Mr Wiscarson’s leadership and performance throughout his period of office, the Committee is minded to consider a payment upon successful implementation of a new strategy in due recognition for all his efforts and achievements.

Executive pay continues to generate public attention. Our focus is upon setting the right level of remuneration without paying too much. The Committee has thought long and hard about what arrangements to put in place that are in the best interests of policyholders, and strongly consider those described as meeting that criterion.

Bonus payments depend on the Society achieving target performance against the Society’s scorecard. Individual performance at an exceeded level against their personal objectives
leads to a higher level of bonus payment, while a ‘not met’ rating results in no bonus being payable.

With the exception of senior staff subject to specific remuneration arrangements under Solvency II, such as deferral, malus and clawback, variable remuneration paid to employees under the discretionary annual bonus scheme represents no more than one-third of their total pay, and in the great majority of cases a much smaller proportion than this.

Non-executive Directors (NEDs) receive only fees and are not eligible to receive benefits, pension or any annual or long-term incentives.

B.1 (c) (ii)
Bonus payments depend on the Society achieving target performance against the Society’s scorecard. The Society’s scorecard and the scorecards of ExCo are approved by the Remuneration Committee.

The Society’s 2018 balanced scorecard is as follows:

<table>
<thead>
<tr>
<th>Objective</th>
<th>Measure</th>
<th>Performance required</th>
</tr>
</thead>
<tbody>
<tr>
<td>Policyholders</td>
<td>Policyholder feedback</td>
<td>Policyholders recognise benefit of any new strategy</td>
</tr>
<tr>
<td></td>
<td>Policyholder views on the Society’s communications</td>
<td>Percentage of positive views less percentage of negative views to be greater than 30%</td>
</tr>
<tr>
<td></td>
<td>Customer Service key performance indicators</td>
<td>Achieve service targets</td>
</tr>
<tr>
<td>Financial</td>
<td>Solvency ratios</td>
<td>Ratios to be within agreed limits</td>
</tr>
<tr>
<td></td>
<td>Expense levels</td>
<td>Not to exceed budget</td>
</tr>
<tr>
<td>Risk</td>
<td>Manage risk within agreed appetite</td>
<td>Detailed operational risk indicators in place, monitored and action taken</td>
</tr>
<tr>
<td>Strategy</td>
<td>Milestones achieved</td>
<td>Public announcement on plan</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Operationally ready for policyholder enquiries</td>
</tr>
<tr>
<td>People</td>
<td>Staff survey</td>
<td>Demonstrable staff advocacy</td>
</tr>
</tbody>
</table>

Objectives set down in the scorecards are cascaded through the Society to ensure that employee objectives are consistent with the Society’s strategy, support delivery of the required performance and effective risk management.

Individual performance at an exceeded level against their personal objectives leads to a higher level of bonus payment, while a ‘not met’ rating results in no bonus being payable.

B.1 (c) (iii)
As previously mentioned NEDs receive only fees and are not eligible to receive benefits, pension or any annual or long-term incentives.
The Society does not provide an occupational pension scheme for Directors. A cash allowance is provided in lieu.

Eligible staff are automatically enrolled into a workplace pension scheme, the Equitable Life Grouped Personal Pension Plan with Legal & General. Under the contribution structure until 30 March 2019, the Society makes a minimum contribution of 6% of basic salary, notwithstanding whether the individual makes a contribution into the Plan. The Society further matches contributions by individuals up to a maximum of 10% of basic salary.

B.1(d)
There were no material related party transactions during 2017.

B.2 Fit and proper requirements

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>B.2</td>
<td>Fit and proper requirements</td>
</tr>
<tr>
<td></td>
<td>The solvency and financial condition report shall include all of the following information regarding the ‘fit and proper’ policy of the insurance or reinsurance undertaking:</td>
</tr>
<tr>
<td>(a)</td>
<td>a description of the undertaking's specific requirements concerning skills, knowledge and expertise applicable to the persons who effectively run the undertaking or have other key functions;</td>
</tr>
<tr>
<td>(b)</td>
<td>a description of the undertaking's process for assessing the fitness and the propriety of the persons who effectively run the undertaking or have other key functions.</td>
</tr>
</tbody>
</table>

B.2 Fit and proper requirements

B.2 (a)
The Society recognises that the operation of an effective system of governance is fundamental to its success. That system is in turn dependent on the fitness and propriety of its Key Function Holders and Key Function Performers. An appropriate Fit and Proper Policy is therefore imperative for ensuring that the Society has the right people in place to enable the sound and prudent management of the business.

The Society seeks to recruit and appoint Approved Persons, Key Function Holders and Key Function Performers who meet and continue to meet requirements in relation to the following:

- Appropriate personal characteristics (including being of good repute and integrity)
- Training
- Creditworthiness
- Experience, knowledge and skills
- Qualifications
- Conduct standards
- Criminal records (barring driving convictions)
- Past business conduct.

B.2 (b)
The Policy specifically requires that the Board be satisfied that the fitness and propriety of any Approved Person or Key Function Holder has been established before they are appointed into role.

Compliance and HR procedures set out requirements for the recruitment and ongoing assessment of Key Function Holders and Key Function Performers. These procedures cover the checks that must be undertaken, references to be obtained, arrangements for ongoing performance management, and requirements for annual review of fitness and propriety.

There are a range of checks that should normally be performed for individuals seeking approval. The regulators' guidance is that firms must perform an appropriate level of due
diligence for a candidate they wish to appoint, which must be carried out before submitting an application. The types of checks will be determined in part by the nature of the role to be undertaken.

Checks will normally include:
- References from current/previous employers covering the last 6 years: these must be regulatory references where appropriate
- Verification of qualifications
- Appropriate personal characteristics (including being of good repute and integrity)
- Creditworthiness
- Criminal records (barring driving convictions)
- Experience, knowledge and skills
- Past business conduct

FCA and PRA require that where an individuals is or was employed by a regulated firm, that the employer must provide a regulatory reference and ‘all relevant information’. The firm may not always provide a regulatory reference where the individual did not perform a regulated role while employed by the firm. In this instance, referral should be made to the Senior Compliance Manager. Regulatory references are also required from organisations where the individual is, or was during the last six years, a NED.

A competency assessment will normally be performed by:
- The CEO for Approved Persons (except NEDs);
- The Chairman for NEDs; or
- Hiring manager in other cases such as the Money Laundering Reporting Officer (MLRO)

The Risk Director will decide who performs the competency assessment for Key Function Holders who do not require approval. The assessment needs to be sufficiently detailed to evidence the relevant competencies and development areas for the individual. A skills analysis is completed and a development plan must be produced to address any gaps, including timeframe for completion of the plan. The plan should include sufficient detail to demonstrate how the gaps will be addressed and who will undertake the training. The annual Fitness and Priority assessments for Non-Executive and Executive Directors is embedded into the annual Board evaluation of performance and annual reviews of directors’ performance. The Chairman’s performance review is led by the Society’s Senior Independent Director. Formal review is recorded at the Society’s Nominations Committee.

For all other staff captured by the new requirements, the annual fitness and propriety assessment are embedded within the Society’s performance management process and staff complete an annual declaration and self-assessment form. The Risk Director reviews the evidence of the annual fitness and propriety checks, seeking satisfactory explanation of (or, if necessary, investigating) any apparent irregularities. He reports to the Chief Executive (CEO) on the outcome of the assessments of fitness and propriety.

B.3.1 Risk management system
The solvency and financial condition report shall include all of the following information regarding the risk management system of the insurance or reinsurance undertaking:

(a) a description of the undertaking’s risk management system comprising strategies, processes and reporting procedures, and how it is able to effectively identify, measure, monitor, manage and report, on a continuous basis, the risks on an individual and aggregated level, to which the undertaking is or could be exposed;
(b) a description of how the risk management system including the risk management function are implemented and integrated into the organisational structure and decision-making processes of the undertaking.

**Guideline 4 - Risk management system for internal model users**

1.16. Under section “B.3 Risk management system including the own risk and solvency assessment” of the SFCR as defined in Annex XX of the Delegated Regulation, insurance and reinsurance undertakings using a partial or a full internal model to calculate the SCR, should describe at least the following information addressing the governance of the internal model:

a) The responsible roles and specific committees if any, their main tasks, position and scope of responsibilities;

b) How existing committees interact with the AMSB in order to meet the requirements of Article 116 of Solvency II Directive;

c) Any material changes to the internal model governance during the reporting period;

d) A description of the validation process (used to monitor the performance and on-going appropriateness of the internal model).

**B.3 Risk management system including the own risk and solvency assessment**

**B.3.1 Risk management system**

**B.3.1 (a)**

The Society’s Risk Management Policy sets out the minimum standards for Equitable Life’s arrangements for ensuring it has robust structures, roles and responsibilities and processes in place to identify and assess, measure, monitor, report and manage the key risks to which the Society’s business is exposed. The Policy states that the Society is committed to:

- Maintaining a strong culture of risk management and controls throughout our business;
- Managing risk in a proportionate and cost effective manner, whilst ensuring compliance with applicable laws and regulations; and
- Having risk management arrangements that support the achievement of our strategic objectives.

The Risk Management Policy states that the ultimate responsibility of oversight of risk management rests with the Board.

The Society follows the widely recognised ‘three lines of defence’ approach to governance, under which primary responsibility for day-to-day risk management and compliance rests with business areas. Oversight and challenge is provided by the Risk and Compliance function as the second line of defence, and independent assurance is provided by Internal Audit as the third line of defence.

The ARC has delegated authority from the Board for reviewing the Society’s internal control and risk management systems, and for monitoring performance against the Board’s risk appetite.

The Risk Director is responsible for ensuring that there is an effective and well-documented Enterprise-wide Risk Management Framework, including:

- A risk and control self-assessment process (RCSA) no less frequently than half-yearly, which requires senior management to attest to the risks and associated controls in place within their area of the business;
• Risk management policies for all principal risk categories. Material changes to these policies are approved by the Board;
• The agreement by the Board of risk appetite statements which are closely linked to the achievement of the Society’s strategic objectives, and key risk indicators for monitoring against risk appetite;
• A robust and consistent approach across the Society for risk identification and risk assessment; and
• Detailed monitoring, review and reporting on material risks, including to the principal management and risk committees.

The Risk Management Framework is designed to meet the requirements and standards set by the PRA and the FCA, and the Solvency II requirements.

Aggregate Risks

Top Risks are those material risks, or aggregation of a number of related material risks:

• Which would have the greatest impact on the delivery of the Society’s strategy, irrespective of their likelihood, or
• Which are currently at ‘front of mind’. For example due to their potential impact on the delivery of the Society’s strategy or some temporary phenomena which increases their likelihood.

Any member of ExCo, ARC or Board can propose a Top Risk, as can the Risk Function. The Risk Director and ExCo must agree that a particular risk be treated as a Top Risk, before it is put to ARC and Board for review and approval. Top Risks are reported monthly to ExCo and the Board, and reviewed quarterly by ARC.

Given the potential for Top Risks to have an adverse impact on the delivery of our strategy, ExCo, ARC and the Board focus attention on ensuring that these risks have been identified and are being properly assessed and managed.

This is particularly relevant in turbulent market conditions. For example, falling interest rates combined with policyholders deferring benefits is a particularly onerous combination. If these risks were to materialise in an economic environment of credit defaults and a divergence of swap and gilt yields, then this would put at risk the current level of capital distribution.

B.3.1 (b)
The Society calculates the Solvency Capital Requirement (SCR) following Standard Formula and does not use an internal model.

The Risk Director is a member of the Executive Committee (ExCo) which ensures that the Risk function is well informed about the strategy and business plans of the Society and the manner in which these are being implemented.

ExCo also has a key role in providing oversight over the adequacy of risk management arrangements in respect of all risk categories.

The risk management function itself is carried out by a team located within the Risk and Compliance Department reporting to the Risk Director.

The roles and responsibilities of the teams within Risk & Compliance are as follows:
• Develop and maintain the ERM Framework and Risk Management policies

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• Develop and distribute a set of risk management tools, techniques, methodologies, analysis and reporting to support the embedding of the ERM Framework
• Ensure that risk management arrangements for the Society are, and continue to be, suitable, proportionate and effective, and that they are consistent with regulatory requirements and expectations
• Support business units in implementing risk policies, tools and mitigants including through provision of suitable communications and training to ensure that the ERM framework is embedded and effective
• Challenge risk registers and other information received from business units
• Consider the relevant category, area and potential accumulation and interactions of risks, including the indirect effect of risks that can occur
• Review regular attestations provided by Strategic third party providers and ensure that they are operating within the boundaries of the Society’s Risk Management Policies and that any issues identified within the attestations are remediated in a timely manner.
• Provide expert advice and guidance to Board, ARC and ExCo on risk management and regulatory compliance matters to inform strategy setting, decision making and the determination of appetite for risk
• Lead the production of the Own Risk and Solvency Assessment Report
• Facilitate risk assessment workshops on key areas of risk and provide templates, training and guidance to support Core Process Risk Assessments.
• Produce timely and relevant risk reporting, including reporting on risk events, mitigating and corrective actions proposed/taken, and on emerging risks.
• Review the basis for assessment of capital attributable to operational risk at least annually, for recommendation to ExCo and Board
• Monitor the Society’s approach to Conduct Risk, providing advice, guidance and challenge as appropriate; including review and challenge of the Conduct Report
• Provide oversight of the design, development, testing and use of the ORSA and SCR capital models
• Review and challenge the Solvency II, ORSA and other financial reporting assumptions and methodologies and
• Consider as part of the annual review the continued appropriateness of the Standard Formula approach, having regard to the risk profile of the Society.
• Review ongoing compliance with the Solvency II Directive, delegated regulations and the System of Governance Guidelines.
• Responsible for day to day relationship with the PRA and FCA, including leading the Society’s response to regulatory developments and initiatives, and reporting any matters of significance, including reportable breaches

Methods through which the Risk function implement their risk strategy

The Society has a documented Enterprise-wide Risk Management Framework which describes the processes that are in place to deliver effective risk management and meet the requirements set out in the Risk Management Policy. Core elements of the Framework are explained below.

Risk appetite
Risk appetite is the amount and type of risk that the Board is willing to accept in pursuit of our business objectives.

The Society’s risk appetite is set annually as part of the Board strategy and business planning process and reviewed half yearly (or more frequently if required), as documented in the Corporate Planning Framework. More detailed granular risk appetites, which flow from and
are aligned with Board risk appetite are set from time to time by ExCo, the Asset and Liability Committee (ALCo). All risks must be managed in accordance with the risk appetite set by the Board and detailed risk appetites.

As per the Risk Management Policy, the Risk Director is responsible for ensuring that there is a process in place to enable the Board’s risk appetite to be set and reviewed regularly. The Risk Director and Chief Actuary are jointly responsible for the recommendation of risk appetite to ExCo and then to the Board.

The risk appetite of the Society is cascaded throughout the Society via Policies and Frameworks. ExCo and ALCo maintain separate lists of risk appetites and associated Key Risk Indicators in respect of the particular risks managed by those committees. Risk appetite is critical because it acts as the ultimate constraint on our activities and so it needs to be embedded into everything we do.

**Risk strategy and plans**
The Society’s Risk Management Strategy is to:

- Maintain a strong culture of risk management and controls throughout our business;
- Manage risk in a proportionate and cost effective manner, whilst ensuring compliance with applicable laws and regulations; and
- Have risk management arrangements that support the achievement of our strategic objectives.

The Risk function’s strategy and functional operating model are reviewed annually by the ExCo in the context of the annual planning cycle.

**Risk Identification and Assessment**
The key tool for risk identification and assessment is the Society’s quarterly Risk and Control Self-Assessment process (RCSA), which is the process used by management to identify their functions’ risks and controls, and assess the impact and likelihood of each of these. Through the RCSA process, functions and projects will highlight those risks that are material (those with Society level impact). Emerging risks will also be highlighted.

The Risk function provides challenge to management to ensure that risks have been identified and that effective controls are in place. Risk reporting is then provided to risk committees, ExCo, Audit & Risk Committee (ARC) and Board for discussion and challenge.

**Risk Measurement**
The Society employs a range of risk measures, metrics and tools to assist in assessing risk exposures and deciding on suitable mitigating actions.

Further, detailed Stress and Scenario analysis and sensitivity testing, including the analysis of a combination of events are used to inform management and the Board about the robustness of the Society’s strategy to adverse foreseeable events.

**Risk monitoring**
The ongoing cycle of risk monitoring includes the maintaining and regular review of risk registers, the risk event reporting process and trend analysis of Key Risk Indicators (KRIIs) by management and committees.

A range of tools and processes are deployed to manage and mitigate risks. These are dependent upon the nature of the risk and the appetite of the Society for that risk. Specific actions to mitigate material risks are discussed at the relevant governance forum(s) to
ensure that they provide sufficient mitigation and that they do not expose the Society to other types of risk for which there is no appetite.

Risk reviews and ‘thematic reviews / deep dives’ are used to enable more intensive review of particular risks at the relevant Committee. These are used where management wants to understand a risk in more detail and/or validate the appropriateness of the impact and likelihood scores or mitigating actions.

### B.3.2 Own risk and solvency assessment

The solvency and financial condition report shall include all of the following information regarding the process the insurance or reinsurance undertaking has adopted to fulfil its obligation to conduct an own risk and solvency assessment:

(a) a description of the process undertaken by the undertaking to fulfil its obligation to conduct an own risk and solvency assessment as part of its risk management system including how the own risk and solvency assessment is integrated into the organisational structure and decision making processes of the undertaking;

(b) a statement detailing how often the own risk and solvency assessment is reviewed and approved by the undertaking’s administrative, management or supervisory body;

(c) a statement explaining how the undertaking has determined its own solvency needs given its risk profile and how its capital management activities and its risk management system interact with each other.

### B.3.2 Own risk and solvency assessment (ORSA)

**B.3.2 (a)**

The ORSA is the Society’s own assessment of the capital that it needs to hold in view of its particular risk exposures, business and strategic plans and risk appetite.

ORSA is an ongoing process throughout the year to evaluate the Society’s view of risks and capital.

The ORSA Report summarises the risks faced by the Society, and how they are managed and mitigated. It explains how, having regard to these risks, capital is assessed to ensure that it is adequate for a 1 in 200 year event. The Report is intended to provide assurance to the Executive Committee (ExCo) and Board that the Society’s overall risk-based capital requirements are met, both over the three year business planning horizon, and in projections over the longer-term.

**ORSA Framework**

The main components of the Framework are:

- **Ongoing processes** which are part of BAU risk management, including risk identification, management and governance, continuous monitoring of the Society’s solvency position and data quality and governance;

- **Other relevant processes** or activities conducted annually, or infrequently, which are not specifically completed for the ORSA, but which provide important input to the ORSA process;

- **Core ORSA processes**, which consist of:
  - Running the ORSA model to produce the ORSA capital requirements, and the Dynamic Distribution Model (DDM) to provide projections of capital and solvency needs over the business planning period;
  - Collating records of all processes involved in the ORSA;
  - Producing the ORSA Report, and appendices;
  - Quality assurance/audit/independent review of the ORSA process.
The above components lead to an ORSA Report that is used by the Society’s Board to take strategic decisions as part of the strategy-setting and business planning process. The report is also a source of information for certain key staff on the risks within the business and the approach to risk management in the context of the Society’s business strategy and risk appetite.

**Preparation of the ORSA Report**

The ORSA Report preparation typically commences in August.

The Risk function leads the preparation of the ORSA Report, coordinating inputs from across the business and ensuring a coherent end-product. A draft of the report is presented to Board alongside the strategy and business plans at the Strategy Setting and Business Planning meetings in November.

After these meetings, the report is revised and presented to December Board for discussion and approval.

The Risk Director provides PRA with a copy of the Society’s Business Plan and ORSA Report once approved by Board, and informs FCA that these documents have been produced.

Throughout the year, ExCo reviews the Society’s risk profile, making reference to the ORSA Report to assess that the actions envisaged are being carried out. The Society’s ExCo and Asset and Liability Committee also pay specific regard to the risks described under ORSA, to ensure that they are being appropriately managed.

Preparation of the ORSA Report is a fundamental part of the Society’s annual strategy process. Its drafting is supervised through the Executive Committee strategy meeting in early October, the Board strategy meeting at the beginning of November, and formally adopted alongside the three year Business Plan at the December Board Meeting. In 2017, Board considered the ORSA Report at meetings in November and December when reviewing the Society’s strategic options.

Board formally reviews the ORSA Report at its mid-year meeting which specifically evaluates progress against the Society’s strategy. At this stage, Board considers whether the approach to the risks as described in the ORSA Report remain appropriate, or whether additional or different actions should be taken. Board also consider whether there have been any emerging risks that merit attention alongside those set down in the ORSA Report. While there have been changes to the Society’s Top Risks, Board confirmed that it was content that the conclusions of the 2016 ORSA Report remain valid.

Should the risk profile of the company materially change, an out of cycle ORSA Report would be prepared.

The ORSA Report is considered before the Society makes major decisions. For example, when considering the Society’s strategy in October, ExCo referred to the 2016 ORSA Report to ensure that the risks had been appropriately and consistently identified.

The ORSA Report is one of the key sources of information used to produce the Solvency and Financial Condition Report and Regular Supervisory Report, required under Solvency II, published for the first time in May 2017.
During 2017, the Society undertook the following activities in relation to solvency measurement:

- Calculation of the ORSA and SCR capital requirements.
- Projection of the solvency capital over the business planning period.
- Stress and scenario testing, including reverse stress testing.
- Monthly reporting of the ORSA and SCR solvency position.

A refresher course on risk management was delivered to managers in 2017. This included the link between risk, capital and solvency coverage.

B.3.2 (b)
The Board are accountable for reviewing and approving, at least annually, the ORSA Policy and the ORSA process results and Report. The Risk function are responsible for providing the ORSA Report to PRA.

B.3.2 (c)
Unlike Standard Formula where many assumptions are specified by EIOPA, the assumptions and methodologies under the ORSA Solvency basis best reflect the Society’s view of its risks.

The Society is required by the regulator to hold solvency capital. It is our strategic intention to distribute all of the assets amongst the with-profit policies as fairly and as soon as possible. Capital Management is a fundamental element of the Society’s risk management system as it aims to meet these two objectives.

The Society’s strategic objectives related to capital management are to:

- Carefully manage solvency to enable capital distribution and, only then, seeking to maximise return; and
- Distribute all of the assets amongst with-profits policyholders as fairly and as soon as possible.

The Board has made the following Key Risk Appetite Statements:

i) Sufficient capital to meet economic and regulatory requirements
ii) Fairness maintained across policyholder generations and distribution policy reflects policyholder expectations of smoothing

Key risk indicators (KRIs) have been set for each of these statements. In the case of i), these are set in terms of the probability of ORSA or SCR coverage falling below certain levels.

The Society’s principal risks are:

- Insurance Risk (Underwriting Risk)
- Liquidity Risk
- Credit Risk
- Market Risk
- Operational Risk
- Regulatory Risk

B.4 Internal control system.

The solvency and financial condition report shall include all of the following information regarding the internal control system of the insurance or reinsurance undertaking:

(a) a description of the undertaking’s internal control system;
(b) a description of how the compliance function is implemented.
B.4 Internal control system.

B.4 (a) The Directors are ultimately responsible for the Society’s system of internal control and for reviewing management’s arrangements for ensuring its effectiveness, including the effectiveness of controls over outsourced activities. This system is designed to manage rather than eliminate the risk of failure to achieve business objectives. The system can only provide reasonable, rather than absolute, assurance against material loss or misstatement. The Directors seek to ensure that the Society mitigates its exposure to risks consistent with its strategy. They also take into consideration the materiality of the risks to be managed and the cost-effectiveness of the relevant aspects of internal control.

As previously mentioned in B.3.1(a) the Society has adopted the widely recognised ‘three lines of defence’ approach to governance.

An appropriate organisational structure for planning, executing, controlling and monitoring business operations is in place in order to achieve the Society’s objectives. The structure is reviewed and updated on a regular basis, taking into account the different priorities of the Society’s business, to ensure that it provides clear responsibilities and control for key areas. Separate functions have been established for Risk Management, Compliance and Internal Audit.

B.4 (b) Primary responsibility for day-to-day compliance rests with business areas. Oversight and challenge is provided by the Compliance function as the second line of defence.

The role and responsibilities of Compliance are:

- Maintaining and developing the Regulatory Risk & Compliance Framework;
- Providing guidance and advice on regulatory matters;
- Reporting regularly on regulatory risks and mitigating actions;
- Maintaining a breach log and monitoring breaches and actions to resolve these, consider root causes and undertake investigations where required, reporting breaches to the PRA/FCA as required under Fundamental Rule 7/Principle 11;
- Preparing management for interactions with the Regulators;
- Providing Key Function Holders and Key Function Performers with training on regulatory matters;
- Managing the relations with PRA and FCA, together with other regulators, including co-ordinating responses to information and other requests;
- Ensuring those undertaking Senior Insurance Management Functions and FCA Controlled Functions have been approved by PRA and FCA, and briefing them on their responsibilities (at approval and at least annually thereafter);
- Ensuring that procedures are in place to assess the fitness and propriety of Key Function Holders and Key Function Performers, during recruitment and on an annual basis;
- Monitoring analyse and report on regulatory developments;
- Producing an annual Compliance Plan setting out priorities for the coming year; and
- Maintaining an up to date set of Compliance Procedures.

**B.5 Internal audit function**

The solvency and financial condition report shall include all of the following information regarding the internal audit function of the insurance or reinsurance undertaking:

(a) a description of how the undertaking's internal audit function is implemented;
(b) a description of how the undertaking's internal audit function maintains its independence and objectivity from the activities it reviews.

**B.5 Internal audit function**

**a) The Internal Audit function**

The Society’s Internal Audit team provides assurance over the operation of governance, risk management and the system of internal control. This team draws on technical audit support from a specialist third party.

The programme of Internal Audit reviews is based on the Society’s risk profile, independently assessed by Internal Audit and reviewed by the Audit and Risk Committee (ARC). The delivery of the Internal Audit plan and the activities to report and track audit findings are reported to, and reviewed by, the ExCo and the ARC.

**b) Organisational Independence**

Independence is the freedom from conditions that threaten the ability of Internal Audit to carry out its responsibilities in an unbiased manner. To achieve this independence the Head of Internal Audit does not perform any operational functions and has direct and unrestricted access to senior management and the Board.

The scope of Internal Audit Assurance activity covers all areas of the Society and includes the review of 2nd line Risk and Compliance functions and services.

The Risk Director has certain responsibilities for both 2nd line and administrative responsibilities for 3rd line activities, risks of reduced independence are mitigated by:

- A clearly articulated and understood dual reporting line for the Head of Internal Audit to the Risk Director and the Chairman of the ARC
- Regular one to one meetings between the Head of Internal Audit and the CEO
- Ensuring that the CEO is the accountable Executive for audits on areas under the responsibility of Risk Director, and that the Chairman of the ARC agrees the scope of such audits;
- Continued use of third party Internal Audit co-sourced services, who also have direct access to the Chairman of the ARC and CEO;
- Co-sourced Internal Audit resource is used to perform any reviews of 2nd line of defence activities that report to the Risk Director;
The ARC annual assessment of the effectiveness of Internal Audit.

Objectivity

Assurance must be delivered in an impartial, unbiased manner and avoid any conflict of interest.

Internal auditors must not perform any operational functions or assess specific operations for which they were previously responsible within the last year or, if longer, within the timeframe covered by the audit.

The Head of Internal Audit has the right of attendance at executive and risk committees, but does not make business decisions as part of this attendance and is not a member of any decision making committees.

B.6 Actuarial function

The solvency and financial condition report shall include a description of how the actuarial function of the insurance or reinsurance undertaking is implemented.

B.6 Actuarial function

The Society’s Actuarial function provides effective actuarial control which allows identification, modelling and control of Financial, Insurance, Operational and Regulatory risks, and supports sound decision-making, capital management and regulatory compliance.

Competence

The Chief Actuary is responsible for ensuring that the Actuarial function has the right mix and level of skills and expertise and meets appropriate standards. This is achieved by:

- Work being carried out by appropriately qualified actuaries, technical staff and other individuals under supervision of actuaries who, themselves, are meeting professional standards;
- Actuarial tasks being planned to ensure there is skilled resource with sufficient time to carry out the right level of internal controls in line with the Materiality and Proportionality Policy. This includes ensuring that there are sufficient and appropriate resources available to ensure that the do/check/review processes are independent;
- Any conflicts (resources, professional or otherwise) being identified, documented and communicated in a timely manner to ExCo and, if appropriate, to other committees or the Board.
- Work meeting the standards set out by the actuarial profession. Requirements are set out in the Institute of Actuaries’ Actuarial Code (including the specific requirements of the Chief Actuary and the With-Profits Actuary). The minimum standards for actuaries are set out by the FRC in a series of Technical Actuarial Standards covering modelling, data, insurance specific work and reporting. These are referred to as TAS 100 and TAS 200 respectively. Internal Checklists provide evidence of compliance with professional standards for all actuarial material referred to the Board and its committees.

The Actuarial function is currently structured as follows:

- Reporting team specialising in stochastic valuations, Solvency II SCR results, ORSA results;
• Actuarial Services team providing data analysis and experience analysis; and

• Actuarial Improvements team providing a controlled and separate area for model, and other, developments.

Teams are led by managers with detailed knowledge of the regulatory environment and the theory and practice of the relevant work. Managers are supported by actuaries, trainee actuaries and other technical specialists (e.g. data analysts, valuation experts) to ensure continuity of knowledge and skills and enable appropriate succession plans to be produced.

The Actuarial function supports external actuaries in providing assurance at the request of the Technical Review Committee or ExCo for material actuarial work used to support the Society’s strategy.

Evidence of appropriate levels of internal control is documented for all actuarial tasks. For smaller tasks, a Project Control Document is used. For actuarial models and their usage, more detailed standard documents are produced, reviewed, challenged and maintained.

Models
Much of the work performed by the Actuarial function for calculating technical provisions and assessing capital requirements is carried out using models.

The key models, together with a brief description of their purpose, are:

• End Of Year System
  Extracts policy valuation data from the administration systems.

• Model Point Creation System
  Puts policy data into a format suitable for valuation models.

• Solvency II SCR Model
  Values the Society’s business in accordance with Solvency II Standard Formula regulations.

• ORSA Model
  Values the Society’s business in accordance with its own views of its risks.

• Dynamic Distribution Model (DDM)
  Projects ORSA and SCR capital requirements and is used in the assessment of the CEF.

• Monthly MI Models
  Produce estimated month-end liability values.

The Society has governance arrangements and controls for models used for material, strategic and business decision-making.

IT resources are sufficient to enable calculations to be performed at the required level of homogeneous risk group and within the prescribed reporting timescales. Adequacy of these resources will be reassessed if they risk compromising the level of detail, level of accuracy (numbers of model points, number of stochastic simulations) or reporting timescales.

Appropriateness of the methodology and assumptions used in calculations of technical provisions and capital requirement is achieved by appropriate internal and independent external review and challenge.

Quality assurance
Actuarial control over the quality of calculations and reports is achieved through the following:

• Maintaining a do / check/ review process for all key calculations. All reports to ExCo, Board and its committees are reviewed by the Chief Actuary;
• Review of Actuarial work is considered as directed by APS X2, issued by The Institute and Faculty of Actuaries;

• Production of Project Control Documents;

• Completion of Checklists to ensure Technical Actuarial Standards and regulatory compliance of reports and calculations;

• Risk assessment of calculation processes;

• Maintenance of a standard spreadsheet template and design protocol to ensure spreadsheets are clear to understand and are subject to change control;

• Production of standard documentation where appropriate to ensure processes carried out correctly and completely: Process diagrams, risk assessments, checklists and procedure notes; and

• Key models built in accordance with agreed specifications. If it is necessary to deviate from the agreed specification, relevant documentation must be amended and re-presented to the appropriate authority for approval and appropriate testing must be carried out subsequently.

• Regular Internal Audit reviews

Data
The closed book and stable systems lead to data consistency and accuracy over time due to the absence of change. Data quality, sufficiency and completeness are achieved by:

• Maintaining data dictionary specifying names of data items, meaning, usage, origin and importance enabling all data items to be identified and understood, used correctly and changes to the data items assessed and understood.

• Extracting policy data at benefit level with validation and reconciliation procedures on key fields in the data production process.

• Reconciling asset data between source and model

• Documenting policy and asset data extraction processes demonstrating source, use and quality of data.

• Complying with Technical Actuarial Standards and documenting any approximations or assumptions applied.

• Completing regular data quality questionnaires and reporting any data quality issues to the Data Quality Manager

Experience Analysis
Best estimates of key valuation assumptions are compared with actual experience and presented to Board on persistency, mortality, expenses and analysis of change in capital resources.

Risk Assessment
As required under the RCSA Process, the Actuarial function has its own risk register which is reviewed at least monthly by the function to identify, categorise and document key risks. The register supports the quarterly RCSA submission.
B.7 Outsourcing

The solvency and financial condition report shall include a description of the outsourcing policy of the insurance or reinsurance undertaking, that undertaking's outsourcing of any critical or important operational functions or activities and the jurisdiction in which the service providers of such functions or activities are located.

The Society uses outsourcers where, due to our lack of scale or areas of expertise, we do not have the ability to provide the service in-house. In these instances, we will go out to the external market and source the provision of these services from the most appropriate Third party service provider who meets our business needs. We manage these third party service providers in accordance with minimum standards for engagement and management of contractual agreements.

All contracts are with UK companies or UK offices of overseas companies.

The Society needs to ensure that contracts with third party providers are only entered into where:
- A clear business need and business benefits have been demonstrated
- An appropriate Third Party has been selected based on a good understanding of the market for the activity and a robust selection process
- The financial implications have been assessed and shown to be acceptable
- It has been demonstrated that adequate governance has supported the decision to enter into the contract
- An appropriate level of due diligence has been undertaken, and the associated risks fully assessed.

The Society needs to ensure that, once a contract is entered into, the contract and the ongoing relationship with the Third Party are appropriately managed over the course of the contract.

The Board and Management are committed to ensuring that:
- All outsourcing arrangements, relating to activities for which the Society remains liable as an authorised entity, are assessed regularly in light of regulatory considerations, and:
  - Written agreements are sufficiently robust to manage not only counterparty risk, but also to minimise exposure to service, regulatory, compliance and reputational risks.

B.8 Any other information

The solvency and financial condition report shall include an assessment of the adequacy of the system of governance of the insurance or reinsurance undertaking to the nature, scale and complexity of the risks inherent in its business.

The solvency and financial condition report shall include in a separate section any other material information regarding the system of governance of the insurance or reinsurance undertaking.
B.8 Any other information

On behalf of the Board, the ARC has reviewed the effectiveness of the risk management and internal control systems for the year ended 31 December 2017, taking into account matters arising up to the end of March 2018.

The review demonstrated that the Society has in place a comprehensive set of risk management and internal control arrangements. These include the identification, assessment, measurement, monitoring, reporting and management of risks. The review also confirmed that the Society is compliant with the Systems of Governance requirements under Solvency II. There have been no material changes to the Society’s Systems of Governance in 2017.

A programme of internal audits and compliance monitoring takes place to provide assurance that the Society’s controls are fit for purpose and that regulatory requirements are being met. No material control issues arose in 2017 and there were no material risk events or breaches during the year. If significant failings or control deficiencies were to be identified, the Committee would confirm whether or not appropriate remedial action had been taken. The review concluded that the Society’s risk management and internal control systems are operating effectively.
C. Article 295 - Risk Profile

C Risk Profile

The solvency and financial condition report shall include qualitative and quantitative information regarding the risk profile of the insurance or reinsurance undertaking, in accordance with paragraphs 2 to 7, separately for the following categories of risk:

(a) underwriting risk;
(b) market risk;
(c) credit risk;
(d) liquidity risk;
(e) operational risk;
(f) other material risks.

The Society operates a comprehensive Risk Management Framework through which it identifies, monitors and reports on the principal risks to its strategic objectives. They are managed within a risk appetite set by the Board, who also ensures that adequate capital is held against these risks.

The main risks relevant to the Society are:

- Insurance risk (Underwriting risk)
- Market risk
- Credit Risk
- Liquidity risk
- Operational risk
- Regulatory risk

C (a) Underwriting Risk

C.2 (a)

The solvency and financial condition report shall include the following information regarding the risk exposure of the insurance or reinsurance undertaking, including the exposure arising from off-balance sheet positions and the transfer of risk to special purpose vehicles:

(a) a description of the measures used to assess these risks within that undertaking, including any material changes over the reporting period;
(b) a description of the material risks that that undertaking is exposed to, including any material changes over the reporting period.
(c) a description of how assets have been invested in accordance with the ‘prudent person principle’ set out in Article 132 of Directive 2009/138/EC so that the risks mentioned in that Article and their proper management are addressed in that description.

C.3 (a)

With regard to risk concentration, the solvency and financial condition report shall include a description of the material risk concentrations to which the insurance or reinsurance undertaking is exposed.

C.4 (a)

With regard to risk mitigation, the solvency and financial condition report shall include a description of the techniques used for mitigating risks, and the processes for monitoring the continued effectiveness of these risk-mitigation techniques.

C.5 (a)

With regard to liquidity risk, the solvency and financial condition report shall include the total amount of the expected profit included in future premiums as calculated in accordance with Article 260(2).

C.6 (a)
With regard to risk sensitivity the solvency and financial condition report shall include a description of the methods used, the assumptions made and the outcome of stress testing and sensitivity analysis for material risks and events.

C.7 (a)
The solvency and financial condition report shall include in a separate section any other material information regarding their risk profile of the insurance or reinsurance undertaking.

Guideline 5 - Underwriting risk

1.17. Under section “C.1 Underwriting risk” of the SFCR as defined in Annex XX of the Delegated Regulation, insurance and reinsurance undertakings should, regarding the use special purpose vehicles, describe if they were authorised under Article 211 of Solvency II Directive, identify the risks that are transferred to it and explain how the fully funded principle is assessed on an ongoing basis.

C (a) Underwriting risk

Underwriting, or Insurance risk is the risk that the actual timing, frequency and severity of insured events differ from that assumed in policy valuations.

For the Society, insurance risk consists of expense risk and the following elements relating to the timing of insured events:

- Persistency risk
- Longevity risk; and
- Mortality risk,

C.2(a)(a)
The Enterprise-wide Risk Management Framework describes the measures used to assess the Society’s risks. Further details are set out in section B3.

The key insurance risks are measured using KRIs.
The Society’s approach to measuring persistency experience is by reviewing the rate at which policies are going off the books against Earliest Contractual Date (ECD), split by contractual and non-contractual exits.
KRIs are maintained by the Actuarial function. Exceptions are reported to ExCo and Board.
As part of the Society’s assessment of the adequacy of its financial resources, Insurance Risks are subject to stress and scenario testing.

There have been no material changes to the measures used to assess these risks over the reporting period.

C.2(b)(a)
Expense risk

The Balance Sheet includes amounts representing the expected value of all future expenses of administration and investment management net of charges made to policy values to pay for these costs. Expense risk is the risk that expenses are higher than those assumed.

The main sources of risks are:
- The assumed future cost base of the business is higher than expected;
- Future inflation of expenses is higher than anticipated; and
- The value of future charges deducted from unit-linked policies is lower than expected.

Risks relating to future expenses are monitored by:
1. Comparing actual expenses against plan; and,
2. Reviewing business plans and strategic projects against run off assumptions.
Expense risk associated with investment management is monitored against levels set within the Investment Guidelines on a daily basis by the With-profits Investment Manager. The performance of the actual assets vs the benchmark is reviewed by ALCo on a monthly basis via the BlackRock reporting. The appropriateness of the benchmark in relation to the actual expense liabilities is reviewed on an annual basis by ALCo.

The active management of expenses using Lean Manufacturing and Simplification techniques continued to be a key focus for the Society in 2017.

**Longevity Risk**
Longevity risk is the risk that policyholders live longer than currently expected, giving rise to the payment of more benefits than currently reserved for.

The Society’s existing exposures to longevity risk have been all but eliminated through reinsurance. The taking-on of additional longevity risk has been eliminated by providing retiring pension policyholders with a Canada Life annuity illustration and emphasising their option to seek annuities in the open market.

**Mortality Risk**
Mortality risk is the risk that policyholders die sooner than currently expected, giving rise to the payment of more death benefits than currently reserved for. A further exposure to mortality risk exists on CWP policies, but these represent only 2% of with-profits policy values.

**Persistency Risk**
Persistency risk is the risk that the timing at which policyholders choose to take their benefits differs from the timing expected. If future experience is different than expected, it can lead to an increase in the cost of the guarantees within policies.

The Society is closed to new business and does not take on new insurance risk. The Society reviews its recent claims experience and combines it with industry-wide data (standard tables of mortality rates) and industry standard models of future annuitant mortality improvement rates in order to derive expectations about future timing of policyholder claims.

**C.2(c)(a)**
PRA’s Prudent Person Principle means firms are expected to exercise prudence in relation to the acquisition and holding of assets and to ensure that assets are appropriate to the nature and duration of liabilities.

The Society’s risk management policies, together with the Asset Management Policy and the Investment Guidelines enable us to identify, measure, monitor, manage, control and report on the risks inherent in the Society’s assets and investments.

These arrangements include requirements relating to the security of assets, their quality and liquidity, and duration, all of which are monitored by the Asset & Liability Management Committee through monthly reporting received from our investment managers, BlackRock and, for unit linked funds, Aberdeen Standard Investments Limited (ASI). The Committee monitors the performance of the investment managers against the Investment Guidelines and objectives set for each portfolio. BlackRock and ASI are also required to report to the Committee on any breaches of the Guidelines, as well as compliance with the Prudent Person Principle and on the actions they have taken, or are taking to rectify such breaches.
C.3(a)
One important risk that has yet to be fully mitigated, is policyholders deferring retirement in a low interest rate environment. Some 80% of the Society’s with profits policies have a built-in guarantee of 3.5% pa. Our assets are invested so that we can pay these guarantees based on when we estimate policyholders will retire. When policyholders stay longer than expected, we have to re-invest the assets at a time when we cannot possibly hope to achieve a 3.5% return.

C4(a)
The methods used to manage and monitor the Society’s risks are set out in section B3. Those specific to insurance risks are described below:

Expense risk
The Society actively manages its costs down, so that business-as-usual costs fall in line with policy run-off. Furthermore, the Society maintains, and regularly reviews, a set of actions it can take to directly control expenses in severe business scenarios.

Most of the Society’s expenses are expected to be linked in some way to UK price inflation. To mitigate the risk of higher than expected rates of inflation, the Society holds a portfolio of index-linked assets in order to match the inflation-linked nature of expenses.

Timing of insured events risk: persistency, longevity and mortality risks
The Society is closed to new business and does not take on new insurance risk.

The Society’s existing exposures to longevity and mortality risk have been all but eliminated through reinsurance. The taking-on of additional longevity risk has been eliminated by providing retiring pension policyholders with a Canada Life annuity illustration and emphasising their option to seek annuities in the open market.

The Society reviews its recent claims experience and combines it with industry-wide data (standard tables of mortality rates) and industry standard models of future annuitant mortality improvement rates in order to derive expectations about future timing of policyholder claims.

To mitigate the impact of with-profits policyholders with a 3.5% pa GIR deferring retirement when interest rates fall, the Society holds a series of derivatives called ‘receiver swaptions’.

These increase in value when interest rates fall or interest rate volatility increases. The effectiveness of the swaption portfolio is reviewed periodically to ensure that it provides adequate protection against a fall in interest rates.

Continued monitoring
Insurance risks are monitored and escalated. Routine monitoring is conducted through the quarterly Risk, Control and Self-Assessment process and regular risk reporting.

C.5(a)
Not Applicable to Underwriting Risk.

C.6(a)
Stress tests comprise movements in a single risk, such as shifts in interest rates.

Scenario tests comprise simultaneous movements in different risks, such as changes to retirement rates, credit spreads, interest rates and expenses.
Both the excess of assets over liabilities and the regulatory capital that would be required under each test are calculated, assuming that the changes occur instantaneously. Reverse stress tests are also performed to determine which event or combinations of events would lead to failure of the business model.

For the purposes of the sensitivities below, the SCR has been adjusted to take account of management actions that could be taken to mitigate the impact of the SCR stress events.

**Expense**

The table below shows the sensitivity to reasonably possible scenarios on the ratios of Own Funds (the excess of assets over liabilities) to the SCR, including the underlying assumptions:

<table>
<thead>
<tr>
<th>Sensitivity scenario</th>
<th>Net impact on solvency coverage ratio 2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>10% increase in assumed level of expenses</td>
<td>-4%</td>
</tr>
<tr>
<td>0.5% increase in assumed rate of UK expense inflation</td>
<td>-1%</td>
</tr>
</tbody>
</table>

**Timing of Insured Events**

The following table shows the sensitivities to possible changes in the timing of when policyholders choose to take their benefits.

<table>
<thead>
<tr>
<th>Impact on solvency coverage ratio</th>
<th>With-profits retirement rates Decrease¹</th>
<th>With-profits retirement rates Increase²</th>
</tr>
</thead>
<tbody>
<tr>
<td>2017</td>
<td>-2%</td>
<td>-</td>
</tr>
</tbody>
</table>

Note:

¹ A change in retirement rates in respect of policies with a guaranteed return of 3.5% pa that is approximately equal to those policyholders delaying retirement by an average of 1 year.

² A change in retirement rates in respect of policies with a guaranteed return of 0% pa that is approximately equal to those policyholders retiring on average one year earlier.

A deferral of policyholders taking their retirements benefits has a significant impact on solvency coverage due to the additional cost of guarantees.

Sensitivity to annuitant longevity risk was all but eliminated following the reinsurance and subsequent transfer of the annuity book to Canada Life. The residual exposure arises from certain with-profits policies that contain a guaranteed minimum level of pension.

While individual risks are important, the Board also considers certain combinations of risks. This is particularly relevant in turbulent market conditions. For example, falling interest rates combined with policyholders deferring benefits is a particularly onerous combination. If these risks were to materialise in an economic environment of credit defaults and a divergence of swap and gilt yields, then this would put at risk the current level of capital distribution.

The Society has held high levels of liquid assets in order to provide protection against the scenario of policyholders who have passed their earliest contractual date (ECD) deciding to take their benefits immediately. The impact of such an event would be immediate claims.
of approximately £1.3bn, and liquid assets significantly in excess of this amount are held in mitigation.

C (b) Market risk

C.2 (b)
The solvency and financial condition report shall include the following information regarding the risk exposure of the insurance or reinsurance undertaking, including the exposure arising from off-balance sheet positions and the transfer of risk to special purpose vehicles:

(a) a description of the measures used to assess these risks within that undertaking, including any material changes over the reporting period;

(b) a description of the material risks that that undertaking is exposed to, including any material changes over the reporting period.

(c) a description of how assets have been invested in accordance with the ‘prudent person principle’ set out in Article 132 of Directive 2009/138/EC so that the risks mentioned in that Article and their proper management are addressed in that description.

C.3 (b)
With regard to risk concentration, the solvency and financial condition report shall include a description of the material risk concentrations to which the insurance or reinsurance undertaking is exposed.

C.4 (b)
With regard to risk mitigation, the solvency and financial condition report shall include a description of the techniques used for mitigating risks, and the processes for monitoring the continued effectiveness of these risk-mitigation techniques.

C.5 (b)
With regard to liquidity risk, the solvency and financial condition report shall include the total amount of the expected profit included in future premiums as calculated in accordance with Article 260(2).

C.6 (b)
With regard to risk sensitivity the solvency and financial condition report shall include a description of the methods used, the assumptions made and the outcome of stress testing and sensitivity analysis for material risks and events.

C.7 (b)
The solvency and financial condition report shall include in a separate section any other material information regarding their risk profile of the insurance or reinsurance undertaking.

C (b) Market Risk

Market risk is the risk of adverse changes in asset values or values of future cash flows of investments. This can arise from fluctuations in interest rates, equity, property and corporate bond prices, and foreign currency exchange rates. The exposure to property and equity risk is immaterial and arises solely through the impact of changes in property and equity values on unit-linked fund charges.

To mitigate the impact of increasing interest rates on asset values, payer swaptions were purchased in 2017.

The main responsibility for monitoring these risks lies with the Society’s Asset and Liability Committee (ALCo).

C.2(a)(b)

Interest rate Risk

The Society measures its exposure to interest rate risk by the duration mismatch between assets and the liabilities. This is monitored on a daily basis by the Investment Manager and reported every other month to ALCo. Also reported is the breakdown of the duration into
Key Rate Durations (KRD). These measures allow the Society to understand the sensitivity to general interest rate market movements and to movements of specific parts of the yield curve.

The market value of the swaption portfolio, and in turn the risk from interest rate volatility, is measured by the Investment Manager and reported to ALCo monthly.

The swaption portfolio is reviewed at least annually to determine whether it is still appropriate as a mitigant against the negative consequences of agreed stress scenarios and falling interest rates.

Spread Risk
Spread risk is measured by a number of metrics calculated by the Investment Manager and provided on a monthly basis to ALCo. These include spread duration and the capital requirement for spread risk.

Liability Matching Risk
Overall cash flow matching risk is monitored monthly by ALCo through:
- Year-by-year matching reports;
- Cumulative matching schedules;
- Key Rate Duration (KRD) active duration (years) tables; and
- KRD monetary impact exposures.

There have been no material changes to the measures used to assess these risks over the reporting period.

C.2(b)(b)
Market risk is considered further by looking at its three elements:

(i) Interest rate risk
Long-term liabilities fluctuate in value because of changes in interest rates. Interest rate risk is the risk that these fluctuations are not fully matched by changes in investment values.

As mentioned under insurance risk C.3(a), there is a further risk for the Society in respect of the guaranteed investment return on with-profits policies, which are typically 3.5% pa. In the current low interest rate environment, the cost of providing these guarantees would increase if interest rates fall further, if policyholders defer their retirement beyond the dates assumed, or if both scenarios occurred together.

The Society is exposed to the risk that increases in interest rates result in a fall in the capital available to distribute to policyholders.

Interest rate volatility is a measure of the likelihood that interest rates will change in the future. This would impact the value of our payer and receiver swaptions.

(ii) Corporate bond spread risk
The capital requirement for credit spread risk has increased by £8m over the year, mainly due to an increase in bond holdings.
The capital requirement is expected to reduce over time as the business runs off. The impact of the reduction is offset, however, by an increase in the proportion of lower rated corporate bonds.

The changes in capital requirement are mainly due to changes in the matching position.

(iii) Currency risk
The capital requirement for currency risk has decreased to £9m (2016: £11m).

C.2(c)(b)
This is described in further detail within section C.2(c) - Credit risk.

C.3(b)
The Society’s approach to the management of market risk is to set limits for specific market risks, and exposure to those risks, to enable effective management of the Society’s solvency level. This is particularly applicable to credit spread risk and duration mismatch, as these can be easily adjusted using market instruments.

The Society’s detailed risk appetite statements, supporting KRI for market risk are set by the ALCo and monitored on a monthly basis.

C.4(b)
Interest rate risk
The Society operates an investment policy so that assets and liabilities are matched. Specifically, the Society holds fixed-interest gilts and corporate bonds to produce income and redemption proceeds that closely match the expected outgoings from with-profits policies and non-profit policies each year. Index linked gilts are held to match the expected outgoings from regular expenses. The Society monitors the exposure to changes in interest rates through periodic reviews of the asset and liability matching position.

To mitigate the impact of increasing interest rates on asset values, payer swaptions were purchased in 2017. These increase in value if the level of interest rates or their expected future volatility increase. In either scenario, the payer swaptions increase in value, and so partially mitigate the associated fall in assets values.

To mitigate the impact of with-profits policyholders with a 3.5% pa GIR deferring retirement when interest rates fall, the Society holds a series of derivatives called ‘receiver swaptions’. These increase in value when interest rates fall or interest rate volatility increases. The effectiveness of the swaption portfolio is reviewed periodically to ensure that it provides adequate protection against a fall in interest rates.

The Society monitors the interest rate volatility risk arising from the swaptions.
The table below illustrates how with-profits investments are mainly in fixed-interest securities:

<table>
<thead>
<tr>
<th>UK with-profits assets mix</th>
<th>2017 %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gilts</td>
<td>51</td>
</tr>
<tr>
<td>Corporate bonds</td>
<td>26</td>
</tr>
<tr>
<td>Short-term gilts and cash</td>
<td>20</td>
</tr>
<tr>
<td>Other</td>
<td>3</td>
</tr>
<tr>
<td></td>
<td>100</td>
</tr>
</tbody>
</table>

In adverse investment conditions, the Society could make appropriate reductions to with-profits policy values and apply financial adjustments to surrenders. These actions mitigate market risk, but do not remove the risk entirely for with-profits policies because the value of assets could still fall short of the value of guarantees within policies.

**Corporate Bond Spread risk**
Corporate bond spread risk is managed through the investment policy, whereby the Society invests in a diversified portfolio of high-quality corporate bonds. The Society’s corporate bond holdings typically have terms of less than eight years, as these are less sensitive to changes in spread than longer dated bonds. The duration of gilt holdings ensures that policy liabilities remained matched.

**Currency risk**
The Society’s principal liabilities are defined in pounds sterling, and its exposure to the risk of movements in foreign exchange rates is limited.

The Society’s financial assets are primarily denominated in the same currencies as its liabilities, which mitigates the foreign exchange rate risk for any overseas operations. The main foreign exchange risk arises from recognised assets denominated in currencies other than those in which insurance and investment liabilities are expected to be settled. The Society invests in a US dollar forward exchange contract to mitigate the most significant exposure to currency risk, and so has very low sensitivity to currency risk.

**Monitoring**
Market risks are monitored and escalated in accordance with the Enterprise-wide Risk Management Framework. Routine monitoring is conducted through:

- The quarterly Risk, Control and Self-Assessment Process.
- Bi-monthly reporting of Insurance and financial risks to the ALCo
- ALCo also receives monthly reporting from the Investment Managers against the Investment Guidelines.

**C.6 (b)**

**Sensitivities**
Please refer to the previous section - Insurance Risk C.6 (a), for further understanding of the methodology underlying stress testing.

**Interest rate risk**
The following table shows the sensitivity solvency coverage to reasonably possible changes in interest rates.
The Society monitors the interest rate volatility risk arising from the swaptions.

The following table shows the sensitivity to reasonably possible scenarios, and shows the increase in sensitivity following the purchase of payer swaptions in 2017.

<table>
<thead>
<tr>
<th>Scenario</th>
<th>Impact on solvency coverage ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest rates, at all terms</td>
<td>2017</td>
</tr>
<tr>
<td></td>
<td>%</td>
</tr>
<tr>
<td>Fall by 0.5% pa</td>
<td>(12)</td>
</tr>
<tr>
<td>Rise by 1.5% pa</td>
<td>104</td>
</tr>
</tbody>
</table>

Corporate bond spreads
The following table shows the sensitivity to reasonably possible scenarios.

<table>
<thead>
<tr>
<th>Scenario</th>
<th>Impact on solvency coverage ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>Change in corporate bond spreads</td>
<td>2017</td>
</tr>
<tr>
<td></td>
<td>%</td>
</tr>
<tr>
<td>Rise 1.5% pa</td>
<td>-</td>
</tr>
<tr>
<td>Rise 1.0% pa</td>
<td>3</td>
</tr>
<tr>
<td>Fall 0.5% pa</td>
<td>-</td>
</tr>
<tr>
<td>Fall 0.25% pa</td>
<td>(1)</td>
</tr>
</tbody>
</table>

Currency risk
The Society is exposed to the risk that movements in foreign exchange rates reduce the value of charges levied on unit-linked business.

The impact of a change of 10% in foreign exchange rates at the reporting date would have reduced the excess of assets by £4m after allowing for the mitigating impact of the US dollar forward exchange contract.

C (c) Credit risk
C.2 (c)
The solvency and financial condition report shall include the following information regarding the risk exposure of the insurance or reinsurance undertaking, including the exposure arising from off-balance sheet positions and the transfer of risk to special purpose vehicles:

(a) a description of the measures used to assess these risks within that undertaking, including any material changes over the reporting period;

(b) a description of the material risks that that undertaking is exposed to, including any material changes over the reporting period.

(c) a description of how assets have been invested in accordance with the ‘prudent person principle’ set out in Article 132 of Directive 2009/138/EC so that the risks mentioned in that Article and their proper management are addressed in that description.
C.3 (c)
With regard to risk concentration, the solvency and financial condition report shall include a description of the material risk concentrations to which the insurance or reinsurance undertaking is exposed.

C.4 (c)
With regard to risk mitigation, the solvency and financial condition report shall include a description of the techniques used for mitigating risks, and the processes for monitoring the continued effectiveness of these risk-mitigation techniques.

C.5 (c)
With regard to liquidity risk, the solvency and financial condition report shall include the total amount of the expected profit included in future premiums as calculated in accordance with Article 260(2).

C.6 (c)
With regard to risk sensitivity, the solvency and financial condition report shall include a description of the methods used, the assumptions made and the outcome of stress testing and sensitivity analysis for material risks and events.

C.7 (c)
The solvency and financial condition report shall include in a separate section any other material information regarding their risk profile of the insurance or reinsurance undertaking.

C (c) Credit risk
C.2 (a)(c)
The key measure of credit risk arising from counterparties is the credit ratings sourced from rating agencies registered as External Credit Assessment Institutions (ECAIs) under EU regulations. The Society relies upon the Investment Manager to assess the ratings, to provide ratings where they are not available from ECAIs and monitor any movements.

The Investment Manager uses the credit ratings in conjunction with the actual exposures to monitor the aggregate portfolio against a series of risk limits, recorded in the Investment Guidelines. The Investment Guidelines govern allocation to different credit rating bands, minimum credit ratings and issuer concentration. Breaches of the Investment Guidelines are reported to the Investment function and ALCo as they occur.

A further credit risk measure is the level of solvency capital held by the Society against the credit risk associated with investing in corporate bonds. This measure is reported monthly by the With-profits Investment Manager. It is also calculated by the Actuarial function. It is monitored against limits provided in the Investment Guidelines.

Risk Reporting is carried out by Risk, informed by KRI's maintained by Actuarial. The Risk Report is reviewed every other month by ALCo, and reported to ExCo and the Board. The KRI's are designed to provide an early warning of increased risk and to highlight where exposure has exceeded or might exceed appetite. These then trigger mitigating actions where appropriate.

The KRI’s also highlight downgrades in ratings and any actual bond defaults. The Investment Manager is responsible for actively measuring and managing credit risk within Bond portfolios.

There have been no material changes to the measures used to assess this risk over the reporting period.

C.2(b)(c)
Credit risk is the risk that a counterparty will fail to pay amounts in full when due. The main credit risks faced by the Society are:
• The risk of default on its portfolio of fixed-interest investments, especially corporate bonds;
• The risk of default by derivative contract counterparties; and
• The risk of default by any of its reinsurers.

The overall change to the Society’s exposure to credit risk in 2017 reflects the run-off of the business and consequent reduction the value of invested assets. Also in 2017 the Society moved out of AA rated short-term gilts into AAA rated pooled deposit funds, which invest in short-term government debt.

C.2(c)(c)
This is described in further detail within section C.2(c)(a).

C.3(c)
The Society’s exposure to credit risk associated with all the Society’s financial assets is summarised below, according to the middle rating of the external credit ratings supplied by Moody’s, Standard & Poor’s, and Fitch.

<table>
<thead>
<tr>
<th>2017</th>
<th>AAA £m</th>
<th>AA £m</th>
<th>A £m</th>
<th>BBB £m</th>
<th>Other £m</th>
<th>Total £m</th>
</tr>
</thead>
<tbody>
<tr>
<td>Debt and other fixed-income securities</td>
<td>132</td>
<td>2,314</td>
<td>445</td>
<td>547</td>
<td>17</td>
<td>3,455</td>
</tr>
<tr>
<td>Deposits and other investments</td>
<td>866</td>
<td>-</td>
<td>14</td>
<td>-</td>
<td>-</td>
<td>880</td>
</tr>
<tr>
<td>Cash at bank and in hand</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>5</td>
<td>-</td>
<td>5</td>
</tr>
<tr>
<td>Other financial assets</td>
<td>2</td>
<td>12</td>
<td>6</td>
<td>11</td>
<td>11</td>
<td>42</td>
</tr>
<tr>
<td>reinsurers’ share of technical provisions and liabilities¹</td>
<td>-</td>
<td>-</td>
<td>402</td>
<td>-</td>
<td>-</td>
<td>402</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>1,000</td>
<td>2,326</td>
<td>867</td>
<td>563</td>
<td>28</td>
<td>4,784</td>
</tr>
</tbody>
</table>

Note
¹ The amount of reinsurers’ share of technical provisions in the table above is based on technical provisions in the 2017 financial statements.

The largest single credit risk exposure amounts to £398m for business reinsured with Scottish Widows. In the event of the insolvency of the reinsurer, if not honoured by the LBG parent company, the Society would be liable for any shortfall between the obligations under the policies and the amounts recovered. The Society holds a further £26m of investments (credit rating A) with LBG.

After LBG, the next largest single credit exposure is £35m, relating to an investment in Bayerische Motoren Werke AG (BMW).

C.4(c)
Management of risk:
Credit risk is monitored by the Society’s Asset and Liability Committee (ALCo). The Society manages its exposure to default on its portfolio of fixed-interest investments through:

• Its policy of only investing in assets of high credit quality;
• Carefully selecting individual investments; and
• Limiting concentrations with any one counterparty.
The potential credit risk exposure from default by both payer and receiver swaption counterparties is mitigated by the receiving of collateral. Collateral of £139m has been received in cash and has been invested in assets similar in nature to cash. The value of these assets at the year-end was £139m.

The potential credit risk exposure from default by futures counterparties is mitigated by daily settlement of variation payments and through trading on a regulated futures exchange. None of the changes in the value of derivatives has been driven by changes in the credit rating of counterparties.

At the reporting date, no material financial assets were past due nor impaired. The Society has not experienced nor expects any significant losses from non-performance by any counterparties.

With regard to reinsurance, steps are taken wherever possible, to limit counterparty risk. The major reinsurance treaties are with Scottish Widows. Reinsurance does not remove the primary liability of the Society to its policyholders, therefore the credit rating of Scottish is monitored closely in order to manage the risk.

**Monitoring**

ALCo is the key decision making body responsible for credit risk mitigation/management. Following review of reporting (as above), actions required to mitigate the risk are devised and responsibilities allotted. This may result in adjustments to policy, strategy or Investment Guidelines.

Implementation of strategy to mitigate/manage credit risk is carried out by BlackRock, ASI, Schroders and Northern Trust to whom the investment management and custody services of the Society have been outsourced. Oversight mechanisms to provide the Society with the required reassurance over the systems and controls operated by third parties are set out in the Asset Management Policy.

Reporting on the embeddedness of this risk policy will be delivered through reports submitted by the Risk function to the ExCo and ALCo.

Daily monitoring to ensure that the exposure to individual counterparties remains within the limits set by the Society is the responsibility of the Investment Managers. Significant events are reported to the Society at the regular meetings held with management.

As part of the Society’s assessment of the adequacy of its financial resources, credit risk exposures are subject to stress testing and scenario analysis. The results of these are reported to the Board, ARC and ALCo.

ALCo also receives a monthly Investment Report from the With-profit Investment Managers and a detailed Stock Lending Report from Northern Trust (the Stock Lending Agent). Unit linked Pricing Committee (UPCo) receives a monthly Investment Report from the Unit-Linked Investment Managers.

This monitoring process is used by management to identify their functions’ risks and controls, and assess the impact and likelihood of each of these.
C.6(c)

Sensitivities
The Society undertakes stress and scenario testing, including reverse stress testing. Stresses and scenarios are used to inform the Executive and Board on the risks faced by the Society from the macro environment.

Market risk tests take account of changes in nominal and real interest rates, changes in credit spreads, the gilt-swap spread and the credit risk adjustment.

Sensitivity to corporate bond spreads are covered in section C.2(b)(b)(iii)

<table>
<thead>
<tr>
<th>C (d)</th>
<th>Liquidity risk</th>
</tr>
</thead>
<tbody>
<tr>
<td>2.6(d)</td>
<td>The solvency and financial condition report shall include the following information regarding the risk exposure of the insurance or reinsurance undertaking, including the exposure arising from off-balance sheet positions and the transfer of risk to special purpose vehicles:</td>
</tr>
<tr>
<td>(a)</td>
<td>a description of the measures used to assess these risks within that undertaking, including any material changes over the reporting period;</td>
</tr>
<tr>
<td>(b)</td>
<td>a description of the material risks that that undertaking is exposed to, including any material changes over the reporting period.</td>
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<tr>
<td>(c)</td>
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</tr>
<tr>
<td>2.3 (d)</td>
<td>With regard to risk concentration, the solvency and financial condition report shall include a description of the material risk concentrations to which the insurance or reinsurance undertaking is exposed</td>
</tr>
<tr>
<td>2.4 (d)</td>
<td>With regard to risk mitigation, the solvency and financial condition report shall include a description of the techniques used for mitigating risks, and the processes for monitoring the continued effectiveness of these risk mitigation techniques.</td>
</tr>
<tr>
<td>2.5 (d)</td>
<td>With regard to liquidity risk, the solvency and financial condition report shall include the total amount of the expected profit included in future premiums as calculated in accordance with Article 260(2).</td>
</tr>
<tr>
<td>2.6 (d)</td>
<td>With regard to risk sensitivity the solvency and financial condition report shall include a description of the methods used, the assumptions made and the outcome of stress testing and sensitivity analysis for material risks and events.</td>
</tr>
<tr>
<td>2.7 (d)</td>
<td>The solvency and financial condition report shall include in a separate section any other material information regarding their risk profile of the insurance or reinsurance undertaking.</td>
</tr>
</tbody>
</table>

C (d) Liquidity risk

Liquidity risk
This is the risk that the Society is unable to meet short-term cash flow requirements, particularly those in respect of policyholders taking their benefits.

C.2 (a)(d)
Analysis of the Society’s activities and its associated sources of liquidity risk is carried out as appropriate by the Finance and Actuarial functions and the Chief Investment Officer.
ALCo reviews the investment policy in the light of any internal or external changes and considers the liquidity risk implications of any material changes. UPCo reviews and approves unit-linked fund mandates to ensure appropriate levels of liquidity are maintained.

The level of liquid assets is measured, and monitored against the amount required to meet a potential mass lapse.

The main mitigant for liquidity risk is the cautious investment policy. Assets are selected in terms of their nature, duration and liquidity in order to meet claims as they fall due. This addresses both short-term and long-term liquidity risk.

Other processes impacting on liquidity risk are the banking and treasury functions ensuring the availability of cleared funds for each day’s payments (including BACS).

There were no material changes to the Society exposure to liquidity risk over the prior year.

C.2(b)(d)
The main source of liquidity risk for the Society is the potential for with-profits policyholder claims to diverge from assumptions requiring forced sale of the Society’s assets. A significant increase in the level of claims, without a sufficient buffer of liquid assets, might give rise to the need to sell illiquid assets on a forced sale basis.

Claims payments as a result of high levels of unit-linked claims would be met by sales of units. There could be a short-period where claims payments need to be made but money from the sale of units has not been received. The impact is not expected to be significant.

C.2(c)(d)
This is described in further detail within section C.2(c)(a) Insurance Risk.

C.3(d)
As per section C.2(b)(d) above

C.4(d)
The Society holds highly liquid assets in excess of short-term cash flow requirements and so has a very low exposure to short-term liquidity risk.

Assets backing linked liabilities are mostly invested in UK listed OEICs. In the unlikely event that OEIC fund managers suspend trading, the Society would be exposed to liquidity risk. The Society has sufficient liquid assets to meet cash flow requirements on linked policies. In extreme scenarios, the Society can defer paying unit-linked claims for up to one month and, in respect of property linked funds, up to six months.

Over the longer term, the Society monitors its forecast liquidity position for with-profits business by estimating the expected cash outflows and purchasing assets with similar durations to meet these obligations. The sensitivity of these outflows to changes in policyholder behaviour is also monitored. Large volumes of surrenders or policyholders taking their benefits earlier than expected can cause the forced sale of illiquid assets at impaired values. If this disadvantages continuing customers, the Financial Adjustment to policy values can be varied to maintain fairness.

Monitoring
ExCo and ALCo are provided a Liquidity and Cash Flow Monitoring Report within the monthly MI pack. Adverse trends and any areas of concern are highlighted.
Liquidity risks are monitored and escalated in accordance with the Enterprise-wise Risk Management Framework. Routine monitoring will be conducted through the quarterly risk and control self-assessment process, regular risk reporting and through ExCo.

This monitoring process is used by management to identify their functions’ risks and controls, and assess the impact and likelihood of each of these.

C.5(d)
The Society closed to new business on 8 December 2000

No credit is taken for expected profits that might arise from premiums in existing policies.

C.6(d)
Sensitivity
The Society's investment strategy and reinsurance arrangements mean that it has a very low exposure to liquidity risk. Even in a scenario such as corporate bonds becoming illiquid, 71% of investment assets held backing insurance and investment liabilities are held in liquid assets such as gilts and cash, which can normally be quickly realised.

Unit-linked contracts can be terminated at any time. The value of unit-linked polices, net of reinsurance, that could be terminated at 31 December 2017 is £1.9bn.

With-profits policies with a contractual payment date prior to 31 December 2017 have a contractual value no lower than total guaranteed benefits, and equalled £1.3bn at 31 December 2017. The liquid assets previously referred to include £3.2bn to back with-profits policies. This is more than sufficient to meet the value of these guaranteed with-profits benefits.

<table>
<thead>
<tr>
<th>C. (e)</th>
<th>Operational risk</th>
</tr>
</thead>
<tbody>
<tr>
<td>C.2(e)</td>
<td>The solvency and financial condition report shall include the following information regarding the risk exposure of the insurance or reinsurance undertaking, including the exposure arising from off-balance sheet positions and the transfer of risk to special purpose vehicles:</td>
</tr>
<tr>
<td>(a)</td>
<td>a description of the measures used to assess these risks within that undertaking, including any material changes over the reporting period;</td>
</tr>
<tr>
<td>(b)</td>
<td>a description of the material risks that that undertaking is exposed to, including any material changes over the reporting period.</td>
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<td>a description of how assets have been invested in accordance with the ‘prudent person principle’ set out in Article 132 of Directive 2009/138/EC so that the risks mentioned in that Article and their proper management are addressed in that description.</td>
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</table>

C.3 (e)
With regard to risk concentration, the solvency and financial condition report shall include a description of the material risk concentrations to which the insurance or reinsurance undertaking is exposed.

C.4 (e)
With regard to risk mitigation, the solvency and financial condition report shall include a description of the techniques used for mitigating risks, and the processes for monitoring the continued effectiveness of these risk-mitigation techniques.

C.5 (e)
With regard to liquidity risk, the solvency and financial condition report shall include the total amount of the expected profit included in future premiums as calculated in accordance with Article 260(2).

C.6 (e)
Operational risk is the potential for loss to result from inadequate or failed internal processes and systems, human error or from external events.

The Society uses a scenario modelling approach to quantify the amount of capital required. Using this approach, the business identifies plausible, but severe, scenarios for the event types based on operational risk data and management experience. These scenarios are used as inputs to an operational risk model, which calculates the operational risk capital required to survive a one in 200 year event.

Further details regarding the measures used to assess the Society’s risks are set out in section B3.

The Board requires that the Society maintains a strong control environment as the Society’s cost base reduces. In support of this Board risk appetite statement, the Society has a series of triggers in place which define its limited appetite. These measures are reviewed at least annually in the context of the Society’s strategy setting process.

More detailed operational risk appetite statements and associated KRIs are set from time to time by ExCo who will review performance against these appetites.

The main sources of operational risk for the Society are:

- Those related to delivery of services to our policyholders;
- The delivery of services to the Society by significant third party suppliers; and
- Risks in executing strategic projects.

Cyber-attacks on companies are a growing threat. These could lead to loss of policyholder data, operational disruption, and reputational damage. Working closely with suppliers, the Board regularly assesses the threat level in the UK, along with the Society’s defences against various potential attacks. Management also conducts simulations to ensure the Society is as prepared as it can be.

The management controls designed to mitigate these risks have succeeded in keeping losses to a bare minimum.

There have been no material changes to operational risk in the year.

On behalf of the Board, the ARC has reviewed the effectiveness of the risk management and internal control systems for the year ended 31 December 2017, taking into account matters arising up to the date of this report.
C.2 (c)(e)
This is described in further detail within section C.2(c)(a) and C.6(a) Insurance Risk.

C.3 (e)
This is described in section C.2(b)(e)

C.4 (e)
The key systems and controls used to manage the Society’s operational risk exposure are described below:

People
- An organisational structure chart for the business, supported by roles and responsibilities/job descriptions for key roles including those undertaken by Approved persons
- An annual programme of computer based training modules to be completed by all staff
- Mid and full year performance reviews for all staff
- Policies and procedures to support recruitment, retention, remuneration and performance management
- Regular staff communications

Processes
- Documented procedures for core processes, including Core Process Risk Assessments where required
- Policies and/or Frameworks for key areas of operational risk such as Third Party Management, Internal Controls, Financial Crime, Complaint Handling, Conflicts of Interest, Data Protection and Whistleblowing

Systems
- An IT strategy which is approved annually by the ExCo and the Board
- An Information Security Policy, Framework and related guidance
- Information Security Cyber Action plan
- An End User Computing (EUC) guidelines
- Identification and assessment of emerging risks, including annual review of global risks by the ARC.

Business Continuity
- Documented arrangements for Business Continuity and IT Disaster Recovery
- Documented and agreed test plans and procedures
- Execution of an annual programme of testing including crisis management scenario tests.
- Periodic crisis management scenario tests.

Monitoring
Routine monitoring will be conducted by management and via ExCo based on regular Operational Risk Reporting produced by the Risk team (including reporting on the outcomes of the quarterly RCSA process).

This monitoring process is used by management to identify their functions’ risks and controls, and assess the impact and likelihood of each of these.
C.6(e)
The Society uses a scenario based approach as the basis for assessment of capital attributable to operational risk. The Society does not perform stress testing for operational risks as such risks are typically independent of market conditions.

C. (f) Other material risks
C.2 (f)
The solvency and financial condition report shall include the following information regarding the risk exposure of the insurance or reinsurance undertaking, including the exposure arising from off-balance sheet positions and the transfer of risk to special purpose vehicles:

(a) a description of the measures used to assess these risks within that undertaking, including any material changes over the reporting period;

(b) a description of the material risks that that undertaking is exposed to, including any material changes over the reporting period.

(c) a description of how assets have been invested in accordance with the ‘prudent person principle’ set out in Article 132 of Directive 2009/138/EC so that the risks mentioned in that Article and their proper management are addressed in that description.

C.3 (f)
With regard to risk concentration, the solvency and financial condition report shall include a description of the material risk concentrations to which the insurance or reinsurance undertaking is exposed

C.4 (f)
With regard to risk mitigation, the solvency and financial condition report shall include a description of the techniques used for mitigating risks, and the processes for monitoring the continued effectiveness of these risk-mitigation techniques.

C.5 (f)
With regard to liquidity risk, the solvency and financial condition report shall include the total amount of the expected profit included in future premiums as calculated in accordance with Article 260(2).

C.6 (f)
With regard to risk sensitivity the solvency and financial condition report shall include a description of the methods used, the assumptions made and the outcome of stress testing and sensitivity analysis for material risks and events.

C.7 (f)
The solvency and financial condition report shall include in a separate section any other material information regarding their risk profile of the insurance or reinsurance undertaking.

C. (f) Other material risks: regulatory risks
C.2(a)(f)
Regulatory risk is the risk to capital and reputation associated with a failure to identify or comply with regulatory requirements and expectations.

Further details regarding the measures used to assess the Society’s risks are set out in section B.3.1.

Heads of Department are responsible for ensuring that all relevant regulatory risks are captured on risk registers which will be reviewed and attested to quarterly. Risk shall be responsible for reviewing areas of concern highlighted as a result of this process and bringing any regulatory matters to the attention of Compliance.

The Society’s Regulatory, Industry and Developments Committee (RIDCo) reporting identifies areas of regulatory change and tracks the approach taken by the Society to implement the required changes.
Compliance provides regular reporting on regulatory matters, including the Society’s arrangements for compliance, to various governance forums (ARC, ExCo, and RIDCo).

C.2(b)(f) / C.3(f)
The main regulatory risk facing the Society is the risk of regulatory sanctions, financial loss or loss of reputation as a result of failure to comply with the laws, regulations, rules and codes of conduct applicable to the Society’s activities.

C.4(f)
Monitoring
The Society has a dedicated Compliance function whose role is to provide advice, guidance and challenge to business areas to assist them in ensuring compliance.

The Compliance function will perform compliance monitoring in accordance with the annual compliance Plan.

Heads of Department are responsible for ensuring that all relevant regulatory risks are captured on the Society’s risk register. These shall be reviewed and attested to quarterly in accordance with the RCSA Guide. Risk shall be responsible for reviewing areas of concern highlighted as a result of this process and bringing any regulatory matters to the attention of Compliance.

This monitoring process is used by management to identify their functions’ risks and controls, and assess the impact and likelihood of each of these.

C.6(f)
The Society does not perform sensitivity tests for regulatory risks. The potential impact of regulatory risks are not reflected in the Balance Sheet, nor do we hold capital against these risks.

The Society considers that any such capital requirements for these are included within the capital requirements for operational risk.

C.7 Any other information
The solvency and financial condition report shall include in a separate section any other material information regarding their risk profile of the insurance or reinsurance undertaking.

C.7 Any other information
At this time there is no further material information regarding the risk profile to report.
### D. Article 296 - Valuation for Solvency Purposes

#### D.1 Assets

The solvency and financial condition report shall include all of the following information regarding the valuation of the assets of the insurance or reinsurance undertaking for solvency purposes:

(a) separately for each material class of assets, the value of the assets, as well as a description of the bases, methods and main assumptions used for valuation for solvency purposes;

(b) separately for each material class of assets, a quantitative and qualitative explanation of any material differences between the bases, methods and main assumptions used by that undertaking for the valuation for solvency purposes and those used for its valuation in financial statements.

**Guideline 6 - Assets - Information on aggregation by class**

1.18. Under section “D.1 Assets” of the SFCR as defined in Annex XX of the Delegated Regulation, insurance and reinsurance undertakings should, when aggregating assets into material classes to describe the valuation basis that has been applied to them, consider the nature, function, risk and materiality of those assets.

1.19. Classes other than those used in the Solvency II balance sheet template as defined in the Implementing Technical Standard with regard to the procedures, formats and templates of the solvency and financial condition report should only be used if the undertaking is able to demonstrate to the supervisory authority that another presentation is clearer and more relevant.

**Guideline 7 - Content by material classes of assets**

1.20. Under section “D.1 Assets” of the SFCR as defined in Annex XX of the Delegated Regulation, insurance and reinsurance undertakings should, in relation to each material class of asset, describe at least the following quantitative and qualitative information:

a) The recognition and valuation basis applied, including methods and inputs used, as well as judgements made other than estimations which would materially affect the amounts recognised, in particular:

i. For material intangible assets: nature of the assets and information on the evidence and criteria used to conclude that an active market exists for those assets;

ii. For material financial assets: information on the criteria used to assess whether markets are active and, if the markets are inactive, a description of the valuation model used;

iii. For financial and operating leasings: describe in general the leasing arrangements in relation to each material class of assets subject to leasing arrangement, separately for financial and operating leases;

iv. For material deferred tax assets: information on the origin of the recognition of deferred tax assets and the amount and expiry date, if applicable, of deductible temporary differences, unused tax losses and unused tax credits for which no deferred tax asset is recognised in the balance sheet;

v. For related undertakings: where related undertakings were not valued using quoted market prices in an active markets or using the adjusted equity method, provide an explanation why the use of these methods was not possible or practical.

b) Any changes made to the recognition and valuation bases used or to estimations during the reporting period;

c) Assumptions and judgments including those about the future and other major sources of estimation uncertainty.

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### D.1 Assets

#### D.1(a) and D.1(b)

The Society’s invested assets are recognised and measured according to UK accounting standards, which are consistent with international accounting standards. Assets are measured at Fair Value, mostly at market (bid) price. Judgement is applied in valuing only a small number of securities (less than 3%), namely interest rate swaptions and private equity investments. There are no areas of concern and no new areas of judgement.
Asset values by category

<table>
<thead>
<tr>
<th></th>
<th>Solvency II 31/12/17 £m</th>
<th>Accrued Income £m</th>
<th>Reclass (Notes) £m</th>
<th>R&amp;A 31/12/17 £m</th>
<th>Solvency II 31/12/16 £m</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Fixed income securities</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Government bonds (incl index linked)</td>
<td>2,329</td>
<td>(13)</td>
<td>9</td>
<td>2,325</td>
<td>3,227</td>
</tr>
<tr>
<td>Corporate bonds</td>
<td>1,158</td>
<td>(19)</td>
<td>(9)</td>
<td>1,130</td>
<td>1,034</td>
</tr>
<tr>
<td></td>
<td>3,487</td>
<td>(32)</td>
<td>-</td>
<td>3,455</td>
<td>4,261</td>
</tr>
<tr>
<td><strong>Other Investments</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Participations (EPEHL)</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>30</td>
</tr>
<tr>
<td>Derivatives</td>
<td>130</td>
<td>130</td>
<td>7</td>
<td>76</td>
<td></td>
</tr>
<tr>
<td>Collective Investments Undertakings</td>
<td>873</td>
<td>(866)</td>
<td>7</td>
<td>382</td>
<td></td>
</tr>
<tr>
<td></td>
<td>1,003</td>
<td>-</td>
<td>(866)</td>
<td>137</td>
<td>488</td>
</tr>
<tr>
<td><strong>Assets held for index-linked and unit linked funds</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Collective Investments Undertakings</td>
<td>1,872</td>
<td>1,872</td>
<td>1,840</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash &amp; equivalents</td>
<td>3</td>
<td>3</td>
<td>6</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other assets including current liabilities</td>
<td>(5)</td>
<td>(5)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>1,870</td>
<td>-</td>
<td>-</td>
<td>1,870</td>
<td>1,846</td>
</tr>
<tr>
<td>Cash &amp; equivalents</td>
<td>14</td>
<td>866</td>
<td>880</td>
<td>19</td>
<td></td>
</tr>
<tr>
<td><strong>Total invested assets</strong></td>
<td>6,374</td>
<td>(32)</td>
<td>-</td>
<td>6,342</td>
<td>6,614</td>
</tr>
<tr>
<td>Corporate cash</td>
<td>5</td>
<td>5</td>
<td>6</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other current assets</td>
<td>10</td>
<td>32</td>
<td>42</td>
<td>18</td>
<td></td>
</tr>
<tr>
<td></td>
<td>15</td>
<td>32</td>
<td>-</td>
<td>47</td>
<td>24</td>
</tr>
<tr>
<td><strong>TOTAL ASSETS</strong></td>
<td>6,389</td>
<td>-</td>
<td>-</td>
<td>6,389</td>
<td>6,638</td>
</tr>
</tbody>
</table>

Notes:
(1) KFW, a German government backed stock, is classified differently for Solvency II and statutory reporting (£9m)
(2) Most non-unit linked collective investments undertakings are cash funds and are classified as ‘cash & equivalents’ in the Report & Accounts (£866m)

As per S.02.01 Solvency II balance sheet quantitative reporting template in Appendix 1 (excluding reinsurance recoverables)

Recognition of assets
The Society recognises a financial asset or a financial liability only when it becomes a party to the contractual provisions of the instrument. Most of the Society’s assets are simple in structure and nature with no ownership issues. However, where assets are being sold or liquidated, special consideration is given to possible derecognition. At 31 December 2017 there were no liquidations or disposals requiring special consideration.

There have been no changes to the recognition and valuation bases used, or to estimations, during the reporting period.
Valuation bases, methods and main assumptions

Fixed income securities
Most of the Society’s investments are fixed income securities. These securities are valued at market price based on a number of types of price source:

- Vendor quoted price
- FTSE Index quoted price
- Broker quoted price
- Model / Internal price
- Cost

Each price source is reviewed on a regular basis, with support from the Society’s fund manager, to ensure that it continues to represent fair value for the asset class being valued. Independent prices are sought where values are subjective, including any securities identified as ‘illiquid’.

No assets have defaulted or been written down in value in the year.

Collective Investments Undertakings (CIUs)
Non-linked Collective Investments Undertakings (CIUs) comprise mostly cash funds, while those within unit linked assets are ‘retail mutual funds’. These are all regulated in accordance with the FCA Collective Investment Schemes Sourcebook (COLL) and are available to other investment clients. In all cases the prices are published daily and the funds are actively traded on an exchange daily. In such circumstances the published price is considered to be the fair value of the asset.

There are no significant collective investments undertakings that are not retail mutual funds or cash funds.

Alternative methods of valuation
Mark to model techniques are used to value:

(h) Participations and private equity - The Society’s only subsidiary, Equitable Private Equity Holdings Ltd was liquidated in 2017 with final dissolution and removal from the Guernsey Register of Companies on 19 March 2018. The underlying investment, the Knightsbridge V Limited Partnership is now held directly by ELAS.

Other investments are mostly private equity and so reported as CIU. Valuation is at net asset value, being a simple, industry standard model that reflects the recoverable amount of the investment. Valuations are reviewed in discussion with the fund manager and significant disposals are compared against carrying value, to confirm that such valuation represents fair value.

(i) Derivatives: Interest rate swaptions (£130m) - valued using an industry standard model. While most inputs to the valuation model are market observable, there is some subjectivity. Significant inputs to the model include interest rate curves and interest rate volatility. The model valuation produces mid-level valuation results, which are compared against those supplied by the swaption counterparties (Morgan Stanley, Goldman Sachs, JP Morgan and Citigroup) to confirm that an alternative set of independently chosen assumptions would not result in a significantly different valuation. Market conditions are assessed to make a conservative estimate of the bid
value. All valuation differences during the period, and at the period end, have been within normal tolerance levels.

Other Assets

- Forward exchange contracts are small in value (Linked: £10k asset, Non-linked £77k asset) and held to hedge currency exposures
- Linked assets include Index Future and Fixed Income Futures (£774k liability), that are all standard exchange-traded contracts with readily available market values
- Cash and cash equivalents represent cash at bank and trading balances held at the custodian
- Other current assets represent a portfolio of loans held against policies, amounts due from policyholders, reassurers and investment brokers and other receivables, valued at recoverable amount.
- The Society has no material intangible assets, leases or deferred tax assets

Assumptions and Uncertainties

Aside from assumptions used for valuation models, as noted above, there are no significant assumptions or uncertainties regarding the valuation of assets.

Active Markets

For fixed income securities, a market is considered to be ‘active’ if trades occur regularly and daily pricing is available. Where there are few, or no, trades or daily pricing is not available, a security is considered ‘stale’ and additional price information sought — generally a second vendor or broker price — to confirm the validity of the price used. The market for all UK government bonds was assessed as active at the year end.

For equity and investment funds, including most of the assets held for unit linked funds, a market is considered ‘active’ if there are trades on a daily basis. Where the market is not active, securities are valued at net asset value, or expected recoverable amount (if lower).

Valuation of assets in the Financial Statements

There are no differences between the bases, methods and main assumptions used in the valuation for solvency purposes and those used for valuation in the Financial Statements.

Asset values in the Solvency II Balance Sheet are shown including accrued interest thereon. In the Financial Statements, the accrued interest is shown separately. This is a difference in presentation and not a valuation difference.

Deferred taxation

In 2016, the Society had £2m of unused tax from realised losses on the disposal of investments. A deferred taxation asset was not recognised in this regard due to uncertainty of recovery. In 2017 there were unrealised gains of £13m, on which a provision for future tax of £3m has been recognised.
The solvency and financial condition report shall include all of the following information regarding the valuation of the technical provisions of the insurance or reinsurance undertaking for solvency purposes:

(a) separately for each material line of business the value of technical provisions, including the amount of the best estimate and the risk margin, as well as a description of the bases, methods and main assumptions used for its valuation for solvency purposes;

(b) a description of the level of uncertainty associated with the value of technical provisions;

(c) separately for each material line of business, a quantitative and qualitative explanation of any material differences between the bases, methods and main assumptions used by that undertaking for the valuation for solvency purposes and those used for their valuation in financial statements;

(d) where the matching adjustment referred to in Article 77b of Directive 2009/138/EC is applied, a description of the matching adjustment and of the portfolio of obligations and assigned assets to which the matching adjustment is applied, as well as a quantification of the impact of a change to zero of the matching adjustment on that undertaking’s financial position, including on the amount of technical provisions, the Solvency Capital Requirement, the Minimum Capital Requirement, the basic own funds and the amounts of own funds eligible to cover the Minimum Capital Requirement and the Solvency Capital Requirement;

(e) a statement on whether the volatility adjustment referred to in Article 77d of Directive 2009/138/EC is used by the undertaking and quantification of the impact of a change to zero of the volatility adjustment on that undertaking’s financial position, including on the amount of technical provisions, the Solvency Capital Requirement, the Minimum Capital Requirement, the basic own funds and the amounts of own funds eligible to cover the Minimum Capital Requirement and the Solvency Capital Requirement;

(f) a statement on whether the transitional risk-free interest rate-term structure referred to Article 308c of Directive 2009/138/EC is applied and a quantification of the impact of not applying the transitional measure on the undertaking’s financial position, including on the amount of technical provisions, the Solvency Capital Requirement, the Minimum Capital Requirement, the basic own funds and the amounts of own funds eligible to cover the Minimum Capital Requirement and the Solvency Capital Requirement;

(g) a statement on whether the transitional deduction referred to in Article 308d of Directive 2009/138/EC is applied and a quantification of the impact of not applying the deduction measure on the undertaking’s financial position, including on the amount of technical provisions, the Solvency Capital Requirement, the Minimum Capital Requirement, the basic own funds and the amounts of own funds eligible to cover the Minimum Capital Requirement and the Solvency Capital Requirement;

(h) a description of the following:

(i) the recoverables from reinsurance contracts and special purpose vehicles;

(ii) any material changes in the relevant assumptions made in the calculation of technical provisions compared to the previous reporting period.

Guideline 8 - Valuation of technical provisions

1.21. Under section “D.2 Technical provisions” of the SFCR as defined in Annex XX of the Delegated Regulation, insurance and reinsurance undertakings should describe the significant simplified methods used to calculate technical provisions, including those used for calculating the risk margin.
### D.2 Technical provisions

#### D.2 (a) Technical Provisions for each line of business

Technical Provisions are the sum of the Best Estimate Liabilities and the Risk Margin. Solvency II uses a best-estimate basis for all assumptions for the calculation of Best Estimate Liabilities. A best estimate basis is one where there is an equal chance of over-estimating the actual experience and under estimating the actual experience. Best Estimate Liabilities are split between the main lines of business and between reassured and non-reassured liabilities, together with a split of the Risk Margin between business types as per S.12.01.02 (Appendix 1).

**December 2017:**

<table>
<thead>
<tr>
<th>£m</th>
<th>With-profit participation</th>
<th>Unit-linked insurance</th>
<th>Other life insurance</th>
<th>Accepted Reinsurance</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Best estimate liabilities (gross)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>3,368</td>
<td>1,929</td>
<td>436</td>
<td>1</td>
<td>5,734</td>
</tr>
<tr>
<td><strong>Risk Margin</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>163</td>
<td>37</td>
<td>17</td>
<td>-</td>
<td>217</td>
</tr>
<tr>
<td><strong>Transitional measures on technical provisions (TMTP)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(1)</td>
<td>(66)</td>
<td>(33)</td>
<td>(1)</td>
<td>-</td>
<td>(100)</td>
</tr>
<tr>
<td><strong>Technical Provisions</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>3,464</td>
<td>1,933</td>
<td>453</td>
<td>1</td>
<td>5,851</td>
</tr>
<tr>
<td><strong>Reinsured Liabilities</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(1)</td>
<td>(9)</td>
<td>(402)</td>
<td>-</td>
<td></td>
<td>(411)</td>
</tr>
<tr>
<td><strong>Technical provisions net of Reinsured Liabilities</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>3,464</td>
<td>1,924</td>
<td>51</td>
<td>1</td>
<td>5,440</td>
</tr>
</tbody>
</table>

(1) Calculation of TMTP is not required to be audited and so was not audited by PricewaterhouseCoopers LLP
Methodology for with-profits business
Technical provisions for recurrent single premium business have been calculated by projecting policy values and guaranteed values, allowing for death rates, surrender (non-contractual termination) rates and retirement rates. For contractual terminations, i.e. deaths and retirements, the amount paid is based on the higher of the projected policy value and the projected guaranteed value. For surrenders, the amount paid is the projected policy value, less any financial adjustment.

After discounting to the valuation date, values are summed across all possible claim dates for all benefit groupings. No allowance is made for capital distribution.

For the purpose of these calculations, investment returns and deflators are based on the risk-free curve defined by EIOPA, i.e. swap yields less the Credit Risk Adjustment (CRA) plus Volatility Adjustment (VA), which is subject to regulatory approval and is only used in the valuation of with-profits benefits. The CRA was 10bp as at the valuation date and the VA was 18bp for sterling denominated business making up more than 99% of with-profit liabilities.

This calculation is repeated across 5,000 stochastic simulations i.e. different possible financial outcomes, and the average liability across these outcomes calculated. This methodology captures the “time value” of the underlying guarantees. In order to reduce model run times, the final model runs are performed using two blocks of 500 simulations that produce the closest match to the cost of guarantees produced by 5,000 simulations. These 1000 simulations are then used in the calculation of liabilities.

A similar methodology is used for conventional with-profits business i.e. endowments and whole of life policies. The sum assured and declared bonus on each policy is first converted into a notional policy value, using final bonus rates and a bonus reserve valuation. Expenses are implicitly allowed for in the premiums valued. Future reversionary bonuses are assumed to be zero.

Methodology for unit-linked business
The unit liability under linked contracts is valued by taking the number of units deemed to attach to policies multiplied by the valuation price per unit as provided by State Street.

At 31 December 2017, all unit liabilities were non-reassured except for c£9m reassured with companies in LBG.

No future premiums are assumed for unit-linked pension policies, only contractual premiums are included for unit-linked life policies.

As at 31 December 2017, the weighted average of the Society’s Annual Management Charge (AMC) across all funds was 0.72% pa. This average may change over time if there are further fund rationalisations.

The present value of unit-linked charges is calculated by applying this charge to the projected value of liabilities, using a cash-flow approach i.e. rolling forward and discounting using the risk-free interest term structure with no VA, allowing for terminations using a multiple decrement approach.

Based on the ratio of the average Aberdeen Standard Investments Limited fund management charge to the average AMC, a proportion of the resultant value of charges is attributed to unit-linked business and included within the expense reserve.
The non-unit liability is calculated using a per-policy projected cash flow methodology. The only non-linked liabilities are in respect of expenses and mortality.

**Methodology for non-profit business (other life insurance)**

Non-profit best estimate liabilities are calculated on a projected cash flow basis, allowing for any escalation in payment or deferment, spouse’s benefits, any minimum or maximum payment term and any change to the level of annuity at a particular age, for example State Pension Age. For index-linked annuities, benefits are first increased by inflation which is implied from nominal and real gilt yields at the valuation date. The resultant cash-flows are discounted at the EIOPA risk-free curve.

For LPI annuities i.e. index-linked annuities with a specified maximum increase rate. The average liability across 1000 stochastic simulations is used, with inflation capped at 5%pa in each simulation for each year of the projection.

**Methodology for expense reserves**

Expense reserves are derived by considering the run-off total expenses rather than building up a picture of the future cost of administering each policy.

The expense model takes the budget for regular expenses in the next year; and a forecast of annual expenses in the years in which: the total number of benefits in force has reduced by half; by three quarters; and the year in which the total number of policies in force has reduced to c1,000. Customer service costs are modelled separately from other administration and support costs.

The budget for customer service costs in the next year is split by product based on the results of an activity cost analysis. Future customer service costs for each product are assumed to run off at a proportion of the reduction in the number of benefits each year. The same proportion is used across all products and in all future years. The proportion is set such that modelled total customer service costs are in line with the forecast of customer service costs in the three years described above.

A similar method is used to model other administration and support costs. They are modelled in aggregate based on the run off of the total number of benefits.

For reporting purposes, customer service costs attributed to each product type are split between non-profit, with-profits and unit-linked business in proportion to the number of benefits. Other administration and support costs are allocated in proportion to policy administration expenses.

Expenses are increased in line with expected inflation, as implied by the difference between nominal and index-linked yield curves at the valuation date.

Allowance is made for the charges made to LBG for administering the reinsured business, which is based on a set of agreed per policy costs for each line of business, applied to a projection of the number of policies and multiplied by the proportion of benefits reinsured at each future date. These costs are increased from the date of the 2009 agreement in line with an agreed sub-index of national average earnings as published by Office for National Statistics, between July 2009 and the valuation date.

Allowance is also made for unit pricing and accounting charges payable to State Street.

The value of investment management fees payable to BlackRock is calculated by running off the current level of charges applicable to with-profits assets in line with policy values.
Charges applicable to assets underlying expense reserves are run-off in line with a projection of the regular expense reserve.

An additional provision is held for future project costs not allowed for in department budgets, e.g. for future regulatory change. Expected inflation is applied to future costs as described above.

The resultant cash-flows are discounted at the risk-free interest rate term structure without VA.

The value of the unit-linked fund management charges described above is added to the total regular expense reserve.

**Assumptions**

In the calculations for with-profit business described above, charges of 2% p.a. of policy values have been allowed for, comprising the following:

- An expense charge of 1% p.a. deducted from policy values.
- A further charge of 1% p.a. deducted from policy values to make some allowance for the expected cost of guarantees and to act as a margin against risk and adverse experience.

Surrender (non-contractual termination) rates are based on recent experience, adjusted for future expected developments / trends. Surrender rates are determined by product type.

Retirement rates for pensions business are based on recent experience for each product type. An adjustment is applied to reflect expected future developments.

In the projection of assets and liabilities it has been assumed that Policy Values would be changed in line with the return on assets less charges.

Future declared reversionary bonus rates are assumed to be zero throughout the projection period, as has been the case since 1999.

The Society’s valuation has been carried out using published mortality tables and an investigation into the Society’s actual mortality experience. The Society continues to make allowance for future improvements in the longevity of annuitants.
### Mortality Assumptions by class of business

<table>
<thead>
<tr>
<th></th>
<th>Current Valuation</th>
<th>Previous Valuation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pension and purchased life annuities</td>
<td>92.5% PNML08 cmi2015 (U=2017)* for males</td>
<td>92.5% PNML08 cmi2015 (U=2016)* for males</td>
</tr>
<tr>
<td></td>
<td>90% PNFL08 cmi2015 (U=2017)* for females</td>
<td>90% PNFL08 cmi2015 (U=2016)* for females</td>
</tr>
<tr>
<td>Permanent assurances</td>
<td>75% AMC00 males</td>
<td>75% AMC00 males</td>
</tr>
<tr>
<td></td>
<td>75% AFC00 for females</td>
<td>75% AFC00 for females</td>
</tr>
<tr>
<td>Temporary assurances</td>
<td>52.5% TMC00 for males</td>
<td>52.5% TMC00 for males</td>
</tr>
<tr>
<td></td>
<td>65% TFC00 for females</td>
<td>65% TFC00 for females</td>
</tr>
<tr>
<td>Pensions in deferment</td>
<td>62.5% AMC00 for males</td>
<td>62.5% AMC00 for males</td>
</tr>
<tr>
<td></td>
<td>67.5% AFC00 for females</td>
<td>67.5% AFC00 for females</td>
</tr>
</tbody>
</table>

* The allowance for mortality improvements is based on the CMI 2015 improvements model with a long-term rate of improvement of 1.5% pa for males and 1.25% pa for females.

Policy Administration expenses are assumed to run-off at a fixed percentage of the projection of the total number of benefits within a specified product grouping. This was set at 80% as at 31 December 2017. (82% December 2016)

Other administration and support costs are assumed to run-off at a fixed percentage of the average benefit run-off rate across all products. This was set at 62% as at 31 December 2017. (64% December 2016)

**Future premiums for with-profits business (contract boundaries)**
The Society is closed to new business and premiums into with-profits Recurrent Single Premium (RSP) policies are only permitted if premiums have been paid in each previous calendar year. This has resulted in very low premiums in respect of RSP business. Technical provisions have therefore been calculated assuming that the only premiums payable will be those contractually due, for example under conventional with-profits policies, term assurances and flexible protection plans.

**Simplifications**
No significant simplifications have been used in the valuation of best estimate liabilities.

**Risk Margin**
The Risk Margin is an addition to the liabilities and is designed to offer extra protection to policyholders against the risk of insurer insolvency. The Risk Margin increases the technical provisions to the amount that would have to be paid to another insurance company in order for them to take on the best estimate liability.

It therefore represents the theoretical compensation for the risk of future experience being worse than best estimate assumptions, and for the cost of holding regulatory capital against this.
The Risk Margin only covers unhedgeable risks. Risks that contribute to the Risk Margin are mortality, longevity, lapse, expense, operational and counterparty default. It is assumed that another insurance company to take on the best estimate liability they would be able to select assets in such a way so as to remove market risk.

The method of calculating the Risk Margin and the degree of simplification used in its calculation is a matter of judgement. The Solvency II regulations included four alternative methods of varying complexity and accuracy. Our chosen methodology is Level 1 of the four level hierarchy. This is the most detailed and accurate of the available methodologies.

Individual risk capital requirements are generally assumed to run-off in line with their respective liability components. For example, lapse risk is assumed to run off in line with with-profit policy values. The actual average run-off of lapse risk in the Society’s projection model, the DDM, is much closer to the run-off of policy values than to any other proxy such as with-profits liabilities.

The capital requirements in respect of mortality risk and operational risk is assumed to run off in line with the with-profits component of technical provisions. Mortality risk is largely proportionate to the amount of with-profits business on the books, whilst operational risk under Solvency II (using the Standard Formula) is expressed directly as a proportion of technical provisions excluding unit-linked business.

Expenses are assumed to run-off in line with the best estimates from the expense model (hence the expense reserve at future valuation dates in base and stress can be calculated by discounting expected cash-flows beyond the valuation date).

Counterparty risk is assumed to run off in line with the reinsured component of best estimate liabilities. The capital requirement for counterparty risk is calculated based on credit rating and the amount recoverable from the counterparty, which is proportionate to the reinsured liabilities. Note that the credit ratings of the counterparties are assumed not to change over time.

The capital requirement for life underwriting risks in the reference undertaking is assumed to be the same (at time zero) as in the original undertaking because it is difficult to eliminate or hedge life underwriting risks.

The Risk Margin has been split between lines of business by first calculating the Risk Margin for each line of business on the assumption that other lines of business do not exist, and then splitting the total Risk Margin in proportion to these amounts.

**Economic Scenario Generator**

For the Society’s with-profits business, an additional cost is generated when policyholders take benefits on contractual terms where their guaranteed fund is in excess of their policy value.

The cost of the guarantee in an individual simulation is the discounted value of the difference between the policy value at retirement and the guaranteed value at retirement, if the guaranteed value is higher than the policy value.

A deterministic calculation using current risk-free yields to derive expected future returns, and hence future policy values, will capture the expected, or ‘intrinsic,’ value of these guarantees. However, there is a wide range of possible outcomes for future investment
returns, and hence future policy values and the cost of guarantees. This additional cost of guarantees arising from the uncertainty of future returns, known as the 'time value' is not captured in the intrinsic value. This can apply even if today a policy has a policy value well in excess of the guarantees.

In order to calculate the cost of the guarantees applying to our with-profits business properly, including the time value described above, the Society is required to undertake a stochastic valuation using a wide range of future investment scenarios. The stochastic simulations are produced by the Economic Scenario Generator (ESG).

The Moody’s Analytics ESG, with nominal interest rates fitted to market swap rates, is used to produce the stochastic simulation file used in the calculation of technical provisions. An adjustment is made within Prophet Life DFA to calibrate the results to the EIOPA risk-free curve, increased by the VA. A separate adjustment is made without VA for the purpose of calculating the Risk Margin. This methodology means that future interest rate paths in the simulations are dispersed either side of the risk-free curve.

In order to reduce model run times, the final model runs are performed using two blocks of 500 simulations that produce the closest match to the cost of guarantees produced by 5,000 simulations.

D.2(b) Level of uncertainty associated with technical provisions

The main uncertainties in technical provisions are in respect of:

- policyholder behaviour. Decreasing retirement rates on average by one year would increase best estimate liabilities by c£31m;
- future expense.
  - Increasing assumed level of future expenses by 5% would increase best estimate liabilities by c£21m
  - Increasing future inflation of expenses by 1% would increase best estimate liabilities by c£43m

D.2(c) Material differences to financial statements

Assets other than the reinsurer’s share of technical provisions are valued consistently for solvency purposes and in the statutory financial statements. Therefore, differences arise solely from differences in the valuation of technical provisions. The material differences between the bases, methods and main assumptions used have been set out with reference to the difference between Excess of Assets over liabilities in the financial statements and Own Funds being the equivalent measure under Solvency II. This is a key measure of capital management for the Society.
The following table shows a breakdown of the material differences to the financial statements.

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount 2017 £m</th>
</tr>
</thead>
<tbody>
<tr>
<td>Excess of Assets over liabilities in financial statements</td>
<td>901</td>
</tr>
<tr>
<td>Difference in valuation assumptions for with-profits business</td>
<td>(43)</td>
</tr>
<tr>
<td>Difference in valuation assumptions for non-profit business</td>
<td>-</td>
</tr>
<tr>
<td>Other valuation differences on expense reserve</td>
<td>(12)</td>
</tr>
<tr>
<td>Adjustment for expected counterparty default rates</td>
<td>(7)</td>
</tr>
<tr>
<td>Risk Margin</td>
<td>(217)</td>
</tr>
<tr>
<td>Transitional Measures to Technical Provisions (TMTP)</td>
<td>100</td>
</tr>
<tr>
<td>Own Funds - before Volatility Adjustment (VA)</td>
<td>723</td>
</tr>
<tr>
<td>Reduction to liabilities for VA</td>
<td>39</td>
</tr>
<tr>
<td>Own Funds - after VA</td>
<td>762</td>
</tr>
</tbody>
</table>

(1) In the financial statements, liabilities are discounted using a gilt yield curve. This is based on the gross redemption yields of government fixed interest securities. Under Solvency II, however, the “risk-free” curve used to discount liabilities is based on swap yields less a Credit Risk Adjustment. The difference in discount rates is the main reason for the difference in the value placed on liabilities.

(2) This is the material difference arising from the prescribed methods used to value reinsured assets under Solvency II, primarily for non-profit business.

(3) The Risk Margin and Transitional Measures are not included in technical provisions in the financial statements and therefore have a direct impact on the difference between Excess of Assets in the financial statements and Own Funds. A further split of these items by line of business can be found in section D.2 (a).

(4) The reduction to liabilities for VA only applies to with-profit liabilities.

(5) There is no difference in the value of unit fund liabilities between the financial statements and the equivalent Solvency II Best Estimate Liabilities.

(6) Calculation of TMTP was not audited by PricewaterhouseCoopers LLP

D.2(d) Matching Adjustment
The Society does not apply a Matching Adjustment in the calculation of Technical Provisions.

D.2(e) Volatility Adjustment
The Volatility Adjustment (VA) is applied to with-profits business in respect to policy related liabilities. The VA is an addition to the yield curve designed to cushion the discounted value of future liabilities from short-term market volatility, and is provided by EIOPA. A positive addition to the yield curve leads to a lower present value of liabilities, as we are discounting future liabilities at a higher rate.
The Society has received PRA approval for use of the VA. The VA is only applied to our with-profits liabilities. The VA is not applied to expense liabilities, unit-linked liabilities or non-profit liabilities. As required by PRA, the VA is assumed to remain unchanged in all SCR stress conditions.

The impact on the Society’s financial position of setting the VA to zero is as follows:

<table>
<thead>
<tr>
<th>£m</th>
<th>Position including VA</th>
<th>Position excluding VA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assets</td>
<td>6,613</td>
<td>6,613</td>
</tr>
<tr>
<td>Technical Provisions</td>
<td>5,851</td>
<td>5,890</td>
</tr>
<tr>
<td>Own Funds*</td>
<td>762</td>
<td>723</td>
</tr>
<tr>
<td>SCR</td>
<td>455</td>
<td>476</td>
</tr>
<tr>
<td>MCR</td>
<td>129</td>
<td>131</td>
</tr>
</tbody>
</table>

*Note that the total value of basic Own Funds is available to cover the SCR and Minimum Capital Requirement (MCR) respectively.

D.2(f) Transitional measure on risk-free interest rates
The Society does not apply the transitional measure on risk-free interest rates.

D.2(g) Transitional measure on technical provisions (TMTP) (1)
The purpose of the Transitional Deduction is to smooth the transition between Solvency I and Solvency II capital requirements by helping to mitigate the impact of the Risk Margin. The Society has approval for the use of a transitional deduction to SII technical provisions based on the solvency position as at 31 December 2015.

The amount of transitional deduction applied as at 31 December 2016 was £107m. If transitional deductions were not applied, total technical provisions would be £107m higher than stated in section D.2 (a) and correspondingly Own Funds would be £107m lower. The SCR and MCR are unaffected by the application of transitional deductions to technical provisions as at 31 December 2016. TMTPs of £107m reduce linearly every year until 2031, with the first reduction on 1 January 2017.

The amount of transitional deduction applied at 31 December 2017 was £100m.

The Society has submitted an application to the PRA for recalculated TMTP, which if approved would reduce TMTP and hence Own Funds by c£30m, as at 31 December 2017. The recalculated TMTP would reduce linearly every year until 2031 and would be c£65m at 31 December 2018.

(1) Calculation of TMTP was not audited by PricewaterhouseCoopers LLP

D.2(h),(i) Reinsurance recoverables
Recoverables from reinsurance contracts are treated as an asset in Solvency II. The value of the reinsurance asset is calculated to be the value of reinsured liabilities less an adjustment to allow for default risk. This adjustment means that the Solvency II balance sheet does not include the full benefit of reinsurance contracts. The adjustment is dependent upon the credit rating of the counterparty and the term of the reassurance agreement.

The amount of reinsurance recoverables is set to the value of best estimate liabilities, less an adjustment for expected counterparty default risk (around 0.25% of technical provisions). This adjustment is calculated allowing for the likelihood of default of each counterparty, in
particular using a credit rating of “A” for the main counterparty, Scottish Widows. A recovery rate of 50% is used, as per the simplification set out in Article 61 of the Delegated Acts.

Further detail on the valuation methodology for non-profit business can be found in section D.2 (a). All deferred annuities and most assurances are reinsured to mitigate longevity and mortality risk as per section C.2(b)(a) of this report.

D.2(h),(ii) Material Changes in Relevant Assumptions

Retirement and Surrender Rates and Expense assumptions.

As at 31 December 2017 the retirement assumptions in respect of retirement rates for with-profits business were updated to reflect experience investigations carried out during the year. Changes to retirement and surrender assumptions over the year decreased the value of liabilities by c£10m.

As at 31 December 2017 assumed future expenses were updated to reflect business forecasts, resulting to an increase in the value of liabilities of c£31m.

D.3 Other liabilities

The solvency and financial condition report shall include all of the following information regarding the valuation of the other liabilities of the insurance or reinsurance undertaking for solvency purposes:

(a) separately for each material class of other liabilities the value of other liabilities as well as a description of the bases, methods and main assumptions used for their valuation for solvency purposes;

(b) separately for each material class of other liabilities, a quantitative and qualitative explanation of any material differences with the valuation bases, methods and main assumptions used by the undertaking for the valuation for solvency purposes and those used for their valuation in financial statements.

Guideline 9 - Liabilities other than technical provisions - information on aggregation by class

1.22. Under section “D.3 Other liabilities” of the SFCR as defined in Annex XX of the Delegated Regulation, insurance and reinsurance undertakings should, when aggregating liabilities other than technical provisions into material classes to describe the valuation basis that has been applied to them consider the nature, function, risk and materiality of those liabilities.

1.23. Classes other than those used in the Solvency II balance sheet template as defined in the Technical Standard on the templates for the submission of information to the supervisory authorities should only be used if the undertaking is able to demonstrate to the supervisory authority that another presentation is clearer and more relevant.

Guideline 10 - Content by material classes of liabilities other than technical provisions

1.24. Under section “D.3 Other liabilities” of the SFCR as defined in Annex XX of the Delegated Regulation, insurance and reinsurance undertakings should, in relation to each material class of liability other than technical provisions, describe at least the following quantitative and qualitative information:

a) Recognition and valuation basis applied, including methods and inputs used, in particular:

i. describe in general the material liabilities arising as a result of leasing arrangements, separately disclosing information on financial and operating leases;

ii. the origin of the recognition of deferred tax liabilities and the amount and expiry date if applicable, of taxable temporary differences;

iii. the nature of the obligation and, if known, expected timing of any outflows of economic benefits and an indication of uncertainties surrounding the amount or timing of the outflows of economic benefits and how deviation risk was taken into account in the valuation;

iv. The nature of the liabilities for employee benefits and a breakdown of the amounts by nature of the liability and the nature of the defined benefit plan assets, the amount of each class of assets, the percentage of each class of assets with respect to the total defined benefit plan assets, including reimbursement rights.
b) Any changes made to the recognition and valuation bases used or on estimations during the reporting period;

c) Assumptions and judgments including those about the future and other major sources of estimation uncertainty.

D.3 Other liabilities

<table>
<thead>
<tr>
<th>OTHER LIABILITIES</th>
<th>At 31 December 2017 £m</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>Other provisions (deferred tax)</td>
<td>3</td>
</tr>
<tr>
<td>Debts owed to credit institutions</td>
<td>3</td>
</tr>
<tr>
<td>Insurance &amp; intermediaries payables</td>
<td>24</td>
</tr>
<tr>
<td>Payables (trade, not insurance)</td>
<td>141</td>
</tr>
<tr>
<td>Accruals</td>
<td>10</td>
</tr>
<tr>
<td><strong>TOTAL OTHER LIABILITIES</strong></td>
<td><strong>181</strong></td>
</tr>
</tbody>
</table>

The deferred tax liability (£3m) has arisen due to increases in value of unit-linked assets which will become taxable in future years. In previous years these assets had unrealised losses resulting from falls in their value, the resulting deferred tax asset was not being recognised due to uncertainty over its recoverability.

Other liabilities are valued at the amount payable and recognised when the obligation to pay arises. Payables includes £139m obligation to repay amounts received as collateral held against the swaption contracts, and £2m in connection with a staff retention bonus scheme.

The Society has no material liabilities arising as a result of leasing arrangements. There are also no significant uncertainties regarding the timing or amounts of other liabilities.

There have been no changes made to the recognition and valuations bases, or estimates used, of other liabilities during the reporting period.

There are no differences between the bases, methods and main assumptions used in the valuation for solvency purposes and those used for valuation in the Financial Statements. Aside from assumptions used for valuation models, as noted above, there are no significant assumptions or uncertainties regarding the valuation of assets.

D.4 Alternative methods for valuation

The solvency and financial condition report shall include information on the areas set out in Article 263 in complying with the disclosure requirements of the insurance or reinsurance undertaking as laid down in paragraphs 1 and 3 of this Article.

D.4 Alternative methods for valuation

There are no differences between the bases, methods and main assumptions used in the valuation for solvency purposes and those used for valuation in the Financial Statements.

Please see section D1 for detail of alternative valuation methods. There are no liabilities valued using alternative valuation methods.
D.5  Any other information
The solvency and financial condition report shall include in a separate section any other material information regarding the valuation of assets and liabilities for solvency purposes.

D.5  Any other information
The Society has submitted an application to the PRA for recalculated TMTP, which if approved would reduce TMTP and hence Own Funds by c£30m.
E. Article 297 - Capital Management

E.1 Own funds
The solvency and financial condition report shall include all of the following information regarding the own funds of the insurance or reinsurance undertaking:

(a) information on the objectives, policies and processes employed by the undertaking for managing its own funds, including information on the time horizon used for business planning and on any material changes over the reporting period;

(b) separately for each tier, information on the structure, amount and quality of own funds at the end of the reporting period and at the end of the previous reporting period, including an analysis of the significant changes in each tier over the reporting period;

(c) the eligible amount of own funds to cover the Solvency Capital Requirement, classified by tiers;

(d) the eligible amount of basic own funds to cover the Minimum Capital Requirement, classified by tiers;

(e) a quantitative and qualitative explanation of any material differences between equity as shown in the undertaking's financial statements and the excess of assets over liabilities as calculated for solvency purposes;

(f) for each basic own-fund item that is subject to the transitional arrangements referred to in Articles 308b(9) and 308b(10) of Directive 2009/138/EC, a description of the nature of the item and its amount;

(g) for each material item of ancillary own funds, a description of the item, the amount of the ancillary own-fund item and, where a method by which to determine the amount of the ancillary own-fund item has been approved, that method as well as the nature and the names of the counterparty or group of counterparties for the items referred to in points (a), (b) and (c) of Article 89(1) of Directive 2009/138/EC;

(h) a description of any item deducted from own funds and a brief description of any significant restriction affecting the availability and transferability of own funds within the undertaking. For the purposes of paragraph (g), the names of the counterparties shall not be disclosed where such disclosure is legally not possible or impracticable or where the counterparties concerned are not material.

Guideline 11 - Own funds - Additional solvency ratios
1.25. Under section “E.1 Own funds” of the SFCR as defined in Annex XX of the Delegated Regulation, where undertakings disclose additional ratios to the ones included in template S.23.01, the SFCR should also include an explanation on the calculation and meaning of the additional ratios.

Guideline 12 - Own funds - Information on the structure, amount, quality and eligibility of own funds
1.26. Under section “E.1 Own funds” of the SFCR as defined in Annex XX of the Delegated Regulation, insurance and reinsurance undertakings should, regarding their own funds, describe at least the following information:

a) for each material own fund item set out in Article 69, Article 72, Article 74, Article 76 and Article 78, as well as for items that received supervisory approval as per Article 79 of the Delegated Regulation the information required in Article 297 (1) of the Delegated Regulation, distinguishing between basic and ancillary own fund items;

b) for each material own fund item, the extent to which it is available, subordinated, as well as its duration and any other features that are relevant for assessing its quality;

c) an analysis of significant changes in own funds during the reporting period, including the value of own fund items issued during the year, the value of instruments redeemed during the year, and the extent to which the issuance has been used to fund redemption;

d) in relation to subordinated debt, an explanation of the changes to its/ their value;

e) when disclosing the information required in Article 297 (1) (c) of the Delegated Regulation, an explanation of any restrictions to available own funds and the impact of limits on eligible Tier 2 capital, Tier 3 capital and restricted Tier 1 capital;

f) details of the principal loss absorbency mechanism used to comply with Article 71 (1)(e) of the Delegated Regulation, including the trigger point, and its effects;

g) an explanation of the key elements of the reconciliation reserve;

h) for each basic own fund item subject to the transitional arrangements:
E.1 Own Funds

Assets other than the reinsurer’s share of technical provisions are valued consistently for solvency purposes and in the statutory financial statements. Therefore, all differences in the value of Own Funds arise from differences in the valuation of technical provisions.

Own Funds consists entirely of the excess of assets over liabilities and is entirely Tier 1. The Society does not have any ordinary share capital, ancillary Own Funds or any other own fund items other than the reconciliation reserve.

The Society’s approach to capital distribution and capital management is set out in the respective sections of the introduction to this report. (1)

Section D.2 (c) sets out the material differences between Own Funds and Excess Assets in the financial statements.

The Society does not apply any transitional measures in respect of Own Fund items, only in respect of the Transitional Measures on Technical Provisions. The amount of eligible Own Funds (Tier 1) to cover the SCR and MCR as at 31 December 2017 is £761,701k (31 Dec16: £831,727k) as per S.23.01. Details of Own Funds can be found in S.23.01.01. (Appendix1)

(1) Calculation of Economic Capital was not audited by PricewaterhouseCoopers LLP

E.2 Solvency Capital Requirement and Minimum Capital Requirement

The solvency and financial condition report shall include all of the following information regarding the Solvency Capital Requirement and the Minimum Capital Requirement of the insurance or reinsurance undertaking:

(a) the amounts of the undertaking’s Solvency Capital Requirement and the Minimum Capital Requirement at the end of the reporting period, accompanied, where applicable, by an indication that the final amount of the Solvency Capital Requirement is still subject to supervisory assessment;

(b) the amount of the undertaking’s Solvency Capital Requirement split by risk modules where that undertaking applies the standard formula, and by risk categories where the undertaking applies an internal model;

(c) information on whether and for which risk modules and sub-modules of the standard formula that undertaking is using simplified calculations;

(1)
E.2 Solvency Capital Requirement and Minimum Capital Requirement

The Society calculates the SCR following Standard Formula and does not use an internal model.

Details of the SCR can be found in S.25.01 and details of the MCR in S.28.01. (Appendix 1) There are no undertaking specific parameters or capital add-ons to report.

Details of the SCR can be found in S.25.01 and details of the MCR in S.28.01. (Appendix 1)

Simplifications

The impact of the catastrophe stress has been estimated based on the sums at risk as per Article 96 of the Delegated Acts.

The impact of the lapse stress has been calculated based on homogenous risk groups rather than policy by policy, a temporary adjustment has been made to allow for the potential increased capital requirement when performing a more granular approach.

Changes to the SCR over the reporting period

The SCR has decreased by £18m over the reporting period, as shown in the table below.

<table>
<thead>
<tr>
<th></th>
<th>£m</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fall in insurance risk</td>
<td>(12)</td>
</tr>
<tr>
<td>Fall in market risk</td>
<td></td>
</tr>
<tr>
<td>Decrease in interest rate risk</td>
<td>(52)</td>
</tr>
<tr>
<td>Increase in exposure to credit spreads</td>
<td>8</td>
</tr>
<tr>
<td>Decrease in diversification benefits</td>
<td>38</td>
</tr>
<tr>
<td>Other changes in market risk</td>
<td>(1)</td>
</tr>
<tr>
<td>Other changes</td>
<td>1</td>
</tr>
<tr>
<td>Change in SCR in the year</td>
<td>(18)</td>
</tr>
</tbody>
</table>

The majority of the change in insurance risk is a fall in lapse risk, due to a rise in swap yields in the year.

The reduction in interest rate risk exposure and the associated reduction in diversification benefits are the result of the purchase of payer swaptions and the improved matching of assets and liabilities.
E.3 Use of the duration-based equity risk sub-module in the calculation of the Solvency Capital Requirement

The solvency and financial condition report shall include all of the following information regarding the option set out in Article 304 of Directive 2009/138/EC:

(a) an indication that that undertaking is using the duration-based equity risk sub-module set out in that Article for the calculation of its Solvency Capital Requirement, after approval from its supervisory authority;

(b) the amount of the capital requirement for the duration-based equity risk sub-module resulting from such use.

E.4 Differences between the standard formula and any internal model used

Where an internal model is used to calculate the Solvency Capital Requirement, the solvency and financial condition report shall also include all of the following information:

(a) a description of the various purposes for which that undertaking is using its internal model;

(b) a description of the scope of the internal model in terms of business units and risk categories;

(c) where a partial internal model is used, a description of the technique which has been used to integrate any partial internal model into the standard formula including, where relevant, a description of alternative techniques used;

(d) a description of the methods used in the internal model for the calculation of the probability distribution forecast and the Solvency Capital Requirement;

(e) an explanation, by risk module, of the main differences in the methodologies and underlying assumptions used in the standard formula and in the internal model;

(f) the risk measure and time period used in the internal model, and where they are not the same as those set out in Article 101(3) of Directive 2009/138/EC, an explanation of why the Solvency Capital Requirement calculated using the internal model provides policy holders and beneficiaries with a level of protection equivalent to that set out in Article 101 of that Directive;

(g) a description of the nature and appropriateness of the data used in the internal model.

Guideline 13 - Differences between the standard formula and internal models used

1.27. Under section “E.4 Differences between the standard formula and any internal model used” of the SFCR as defined in Annex XX of the Delegated Regulation, insurance and reinsurance undertakings should, when disclosing the main differences in methodologies and underlying assumptions used in the standard formula and in the internal model, describe at least the following:

a) Structure of the internal model;

b) Aggregation methodologies and diversification effects;

c) Risks not covered by the standard formula but covered by the internal model.

E.4 Differences between the Standard Formula and any internal model used

The Society calculates the SCR following Standard Formula and does not use an internal model.

E.5 Non-compliance with the Minimum Capital Requirement and non-compliance with the Solvency Capital Requirement

The solvency and financial condition report shall include all of the following information regarding any non-compliance with the Minimum Capital Requirement or significant non-compliance with the Solvency Capital Requirement of the insurance or reinsurance undertaking:
(a) regarding any non-compliance with that undertaking's Minimum Capital Requirement: the period and maximum amount of each non-compliance during the reporting period, an explanation of its origin and consequences, any remedial measures taken, as provided for under Article 51(1)(e)(v) of Directive 2009/138/EC and an explanation of the effects of such remedial measures;

(b) where non-compliance with the undertaking's Minimum Capital Requirement has not been subsequently resolved: the amount of the non-compliance at the reporting date;

(c) regarding any significant non-compliance with the undertaking's Solvency Capital Requirement during the reporting period: the period and maximum amount of each significant non-compliance and, in addition to the explanation of its origin and consequences as well as any remedial measures taken, as provided for under Article 51(1)(e)(v) of Directive 2009/138/EC and an explanation of the effects of such remedial measures;

(d) where a significant non-compliance with the undertaking's Solvency Capital Requirement has not been subsequently resolved: the amount of the non-compliance at the reporting date.

E.5 Non-compliance with the Minimum Capital Requirement and non-compliance with the Solvency Capital Requirement

There was no non-compliance with either the MCR or SCR over the reporting period.

E.6 Any other information

The solvency and financial condition report shall include in a separate section any other material information regarding the capital management of the insurance or reinsurance undertaking.

E.6 Any other information

At this time there is no other material information to disclose

Article 298 Additional voluntary information

Where insurance and reinsurance undertakings disclose publicly, in accordance with Article 54(2) of Directive 2009/138/EC, any information or explanation related to their solvency and financial condition whose public disclosure is not legally required these undertakings shall ensure that such additional information is consistent with any information provided to the supervisory authorities pursuant to Article 35 of that Directive.

At this time there is no other material information to disclose
APPENDIX 1: Quantitative Reporting Template Disclosures

General information

<table>
<thead>
<tr>
<th>Undertaking name</th>
<th>Equitable Life Assurance Society</th>
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<td>Type of undertaking</td>
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<td>Standard formula</td>
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<td>Transitional measure on the risk-free interest rate</td>
<td>No use of transitional measure on the risk-free interest rate</td>
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<tr>
<td>Transitional measure on technical provisions</td>
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List of reported templates

S.02.01.02 - Balance sheet
S.05.01.02 - Premiums, claims and expenses by line of business
S.12.01.02 - Life and Health SLT Technical Provisions
S.22.01.21 - Impact of long term guarantees measures and transitionals
S.23.01.01 - Own Funds
S.25.01.21 - Solvency Capital Requirement - for undertakings on Standard Formula
S.28.01.01 - Minimum Capital Requirement - Only life or only non-life insurance or reinsurance activity
### Balance sheet

#### Assets

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<td>R0050</td>
<td>Pension benefit surplus</td>
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<td>R1000</td>
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## Premiums, claims and expenses by line of business

### Life

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<tr>
<th>Line of Business for: life insurance obligations</th>
<th>Life reinsurance obligations</th>
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<td>Health insurance</td>
<td>Insurance with profit participation</td>
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#### Premiums written

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<thead>
<tr>
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<th>Reinsurers' share</th>
<th>Net</th>
<th></th>
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</thead>
<tbody>
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<td>9,737</td>
<td>5,320</td>
<td>201</td>
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<td>R1420</td>
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<tr>
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#### Premiums earned

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<th>Gross</th>
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<th>Net</th>
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</thead>
<tbody>
<tr>
<td>R1510</td>
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<td>9,737</td>
<td>5,320</td>
<td>201</td>
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<td>1,203</td>
<td>112</td>
<td>6,228</td>
<td>0</td>
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<tr>
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<td>9,625</td>
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#### Claims incurred

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#### Changes in other technical provisions

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<td>0</td>
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Life and Health SLT Technical Provisions

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<tr>
<th>Insurance with profit participation</th>
<th>Index-linked and unit-linked insurance</th>
<th>Other life insurance</th>
<th>Annuities stemming from non-life insurance contracts and relating to insurance obligation other than health insurance</th>
<th>Accepted reinsurance</th>
<th>Total SL(e) other than health insurance, including Unit-Linked</th>
<th>Health insurance (direct business)</th>
<th>Annuities stemming from non-life insurance contracts and relating to health insurance obligations</th>
<th>Health reinsurance (reinsurance accepted)</th>
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<td>R0020</td>
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<td>C0030</td>
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<td>C0060</td>
<td>C0070</td>
<td>C0080</td>
<td>C0090</td>
<td>C0100</td>
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Technical provisions calculated as a sum of BE and RM

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<th>Total Recoverables from reinsurance/SPV and Finite Re after the adjustment for expected losses due to counterparty default</th>
<th>Best estimate minus recoverables from reinsurance/SPV and Finite Re</th>
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<th>Amount of the transitional on Technical Provisions</th>
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Amount of the transitional on Technical Provisions

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<td>0</td>
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<td>0</td>
<td>0</td>
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</tbody>
</table>

Risk margin

| Risk margin | -66,469 | -32,813 | -1,021 | -100,313 |

Risk margin

R0120

| Risk margin | -66,469 | -32,813 | -1,021 | -100,313 |

Total technical provisions - total

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Impact of long term guarantees measures and transitionals

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<th>Impact of transitional on interest rate</th>
<th>Impact of volatility adjustment set to zero</th>
<th>Impact of matching adjustment set to zero</th>
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<tr>
<td>R0100 Eligible own funds to meet Minimum Capital Requirement</td>
<td>761,701</td>
<td>-100,313</td>
<td>0</td>
<td>-39,134</td>
</tr>
<tr>
<td>R0110 Minimum Capital Requirement</td>
<td>128,974</td>
<td>0</td>
<td>0</td>
<td>1,752</td>
</tr>
</tbody>
</table>
### S.23.01.01

#### Own Funds

**Basic own funds before deduction for participations in other financial sector as foreseen in article 68 of Delegated Regulation 2015/35**

<table>
<thead>
<tr>
<th>Description</th>
<th>Tier 1</th>
<th>Tier 1</th>
<th>Tier 2</th>
<th>Tier 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>C0010 Ordinary share capital (gros of own shares)</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>C0020 Share premium account related to ordinary share capital</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>C0030 Initial funds, members' contributions or the equivalent basic own fund item for mutual and mutual-type undertakings</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>C0040 Subordinated mutual member accounts</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>C0050 Surplus funds</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>C0060 Preference shares</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>C0070 Share premium account related to preference shares</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>C0080 Reconciliation reserve</td>
<td>761,701</td>
<td>761,701</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>C0090 Subordinated liabilities</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>C0100 An amount equal to the value of net deferred tax assets</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>C0110 Other own fund items approved by the supervisory authority as basic own funds not specified above</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>C0120 Own funds from the financial statements that should not be represented by the reconciliation reserve and do not meet the criteria to be classified as Solvency II own funds</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>C0130 Deductions for participations in financial and credit institutions</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>C0140 Total basic own funds after deductions</td>
<td>761,701</td>
<td>761,701</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>

**Ancillary own funds**

<table>
<thead>
<tr>
<th>Description</th>
<th>Tier 1</th>
<th>Tier 1</th>
<th>Tier 2</th>
<th>Tier 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>R0300 Unpaid and uncalled ordinary share capital callable on demand</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>R0310 Unpaid and uncalled initial funds, members' contributions or the equivalent basic own fund item for mutual and mutual-type undertakings, callable on demand</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>R0320 Unpaid and uncalled preference shares callable on demand</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>R0330 A legally binding commitment to subscribe and pay for subordinated liabilities on demand</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>R0340 Letters of credit and guarantees under Article 96(2) of the Directive 2009/138/EC</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>R0350 Letters of credit and guarantees other than under Article 96(2) of the Directive 2009/138/EC</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>R0360 Supplementary members calls under first subparagraph of Article 96(3) of the Directive 2009/138/EC</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>R0370 Supplementary members calls - other than under first subparagraph of Article 96(3) of the Directive 2009/138/EC</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>R0380 Other ancillary own funds</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>C0150 Total ancillary own funds</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>

**Available and eligible own funds**

<table>
<thead>
<tr>
<th>Description</th>
<th>Tier 1</th>
<th>Tier 1</th>
<th>Tier 2</th>
<th>Tier 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>R0500 Total available own funds to meet the SCR</td>
<td>761,701</td>
<td>761,701</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>R0510 Total available own funds to meet the MCR</td>
<td>761,701</td>
<td>761,701</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>R0520 Total eligible own funds to meet the SCR</td>
<td>761,701</td>
<td>761,701</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>R0530 Total eligible own funds to meet the MCR</td>
<td>761,701</td>
<td>761,701</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>R0540 SCR</td>
<td>455,063</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>R0550 MCR</td>
<td>128,974</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>R0560 Ratio of Eligible own funds to SCR</td>
<td>167.38%</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>R0570 Ratio of Eligible own funds to MCR</td>
<td>590.39%</td>
<td></td>
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</tr>
</tbody>
</table>

**Reconciliation reserve**

<table>
<thead>
<tr>
<th>Description</th>
<th>Tier 1</th>
<th>Tier 1</th>
<th>Tier 2</th>
<th>Tier 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>C0060 Reconciliation reserve</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>R0700 Excess of assets over liabilities</td>
<td>761,701</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>R0710 Own shares (held directly and indirectly)</td>
<td>0</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>R0720 Foreseeable dividends, distributions and charges</td>
<td>0</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>R0730 Other basic own fund items</td>
<td>0</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>R0740 Adjustment for restricted own fund items in respect of matching adjustment portfolios and ring fenced funds</td>
<td>0</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>R0760 Reconciliation reserve</td>
<td>761,701</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Expected profits**

<table>
<thead>
<tr>
<th>Description</th>
<th>Tier 1</th>
<th>Tier 1</th>
<th>Tier 2</th>
<th>Tier 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>R0770 Expected profits included in future premiums (EPFP) - Life business</td>
<td>0</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>R0780 Expected profits included in future premiums (EPFP) - Non-life business</td>
<td>0</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>R0790 Total expected profits included in future premiums (EPFP)</td>
<td>0</td>
<td></td>
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</tr>
</tbody>
</table>
Solvency Capital Requirement - for undertakings on Standard Formula

<table>
<thead>
<tr>
<th>Risk Category</th>
<th>SCR (€)</th>
<th>USP</th>
<th>Simplifications</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Gross solvency capital requirement</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>R0010 Market risk</td>
<td>94,283</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>R0020 Counterparty default risk</td>
<td>15,721</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>R0030 Life underwriting risk</td>
<td>398,134</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>R0040 Health underwriting risk</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>R0050 Non-life underwriting risk</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>R0060 Diversification</td>
<td>-71,919</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>R0070 Intangible asset risk</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td><strong>Basic Solvency Capital Requirement</strong></td>
<td>436,218</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Calculation of Solvency Capital Requirement</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>R0130 Operational risk</td>
<td>19,070</td>
<td></td>
<td></td>
</tr>
<tr>
<td>R0140 Loss-absorbing capacity of technical provisions</td>
<td>-225</td>
<td></td>
<td></td>
</tr>
<tr>
<td>R0150 Loss-absorbing capacity of deferred taxes</td>
<td>0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>R0160 Capital requirement for business operated in accordance with Art. 4 of Directive 2003/41/EC</td>
<td>0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>R0200 Solvency Capital Requirement excluding capital add-on</td>
<td>455,063</td>
<td></td>
<td></td>
</tr>
<tr>
<td>R0210 Capital add-ons already set</td>
<td>0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>R0220 Solvency capital requirement</td>
<td>455,063</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Other information on SCR</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>R0400 Capital requirement for duration-based equity risk sub-module</td>
<td>0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>R0410 Total amount of Notional Solvency Capital Requirements for remaining part</td>
<td>0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>R0420 Total amount of Notional Solvency Capital Requirements for ring fenced funds</td>
<td>0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>R0430 Total amount of Notional Solvency Capital Requirements for matching adjustment portfolios</td>
<td>0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>R0440 Diversification effects due to RFF nSCR aggregation for article 304</td>
<td>0</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Minimum Capital Requirement - Only life or only non-life insurance or reinsurance activity

### Linear formula component for non-life insurance and reinsurance obligations

<table>
<thead>
<tr>
<th>Description</th>
<th>Result</th>
</tr>
</thead>
<tbody>
<tr>
<td>Medical expense insurance and proportional reinsurance</td>
<td></td>
</tr>
<tr>
<td>Income protection insurance and proportional reinsurance</td>
<td></td>
</tr>
<tr>
<td>Workers’ compensation insurance and proportional reinsurance</td>
<td></td>
</tr>
<tr>
<td>Motor vehicle liability insurance and proportional reinsurance</td>
<td></td>
</tr>
<tr>
<td>Other motor insurance and proportional reinsurance</td>
<td></td>
</tr>
<tr>
<td>Marine, aviation and transport insurance and proportional reinsurance</td>
<td></td>
</tr>
<tr>
<td>Fire and other damage to property insurance and proportional reinsurance</td>
<td></td>
</tr>
<tr>
<td>General liability insurance and proportional reinsurance</td>
<td></td>
</tr>
<tr>
<td>Credit and suretyship insurance and proportional reinsurance</td>
<td></td>
</tr>
<tr>
<td>Legal expenses insurance and proportional reinsurance</td>
<td></td>
</tr>
<tr>
<td>Assistance and proportional reinsurance</td>
<td></td>
</tr>
<tr>
<td>Miscellaneous financial loss insurance and proportional reinsurance</td>
<td></td>
</tr>
<tr>
<td>Non-proportional health reinsurance</td>
<td></td>
</tr>
<tr>
<td>Non-proportional casualty reinsurance</td>
<td></td>
</tr>
<tr>
<td>Non-proportional marine, aviation and transport reinsurance</td>
<td></td>
</tr>
<tr>
<td>Non-proportional property reinsurance</td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>128,974</td>
</tr>
</tbody>
</table>

### Linear formula component for life insurance and reinsurance obligations

<table>
<thead>
<tr>
<th>Description</th>
<th>Result</th>
</tr>
</thead>
<tbody>
<tr>
<td>Obligations with profit participation - guaranteed benefits</td>
<td></td>
</tr>
<tr>
<td>Obligations with profit participation - future discretionary benefits</td>
<td></td>
</tr>
<tr>
<td>Index-linked and unit-linked insurance obligations</td>
<td></td>
</tr>
<tr>
<td>Other life (re)insurance and health (re)insurance obligations</td>
<td></td>
</tr>
<tr>
<td><strong>Total capital at risk for all life (re)insurance obligations</strong></td>
<td>297,536</td>
</tr>
</tbody>
</table>

### Overall MCR calculation

<table>
<thead>
<tr>
<th>Description</th>
<th>Result</th>
</tr>
</thead>
<tbody>
<tr>
<td>Linear MCR</td>
<td>128,974</td>
</tr>
<tr>
<td>SCR</td>
<td>455,063</td>
</tr>
<tr>
<td>MCR cap</td>
<td>204,778</td>
</tr>
<tr>
<td>MCR floor</td>
<td>113,766</td>
</tr>
<tr>
<td>Combined MCR</td>
<td>128,974</td>
</tr>
<tr>
<td>Absolute floor of the MCR</td>
<td>3,251</td>
</tr>
<tr>
<td><strong>Minimum Capital Requirement</strong></td>
<td>128,974</td>
</tr>
</tbody>
</table>