

LV= GROUP

Solvency II Single Group Solvency and
Financial Condition Report

For the year ended 31st December 2016

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Statement of directors' responsibilities

Financial period ended 31st December 2016

We certify that:

- a) The Solvency and Financial Condition Report has been properly prepared in all material respects in accordance with the PRA rules and Solvency II Regulations; and
- b) We are satisfied that:
 - i. throughout the financial year in question, the Group and its subsidiaries have complied in all material respects with the requirements of the PRA rules and Solvency II Regulations as applicable to the Group; and
 - ii. it is reasonable to believe that, at the date of the publication of the Solvency and Financial Condition Report, the Group and its subsidiaries has continued so to comply, and will continue so to comply in future.

The Solvency and Financial Condition Report was approved by the Board of Directors on 21st June 2017 and signed on its behalf by:



P W Moore
Group Finance Director

Liverpool Victoria Friendly Society Limited
County Gates
Bournemouth
BH1 2NF

Independent auditors’ report on the Solvency and Financial Condition Report

Report of the external independent auditors to the Directors of Liverpool Victoria Friendly Society Limited (‘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 Single Group-Wide Solvency and Financial Condition Report

Opinion

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

- The ‘Valuation for solvency purposes’ and ‘Capital Management’ sections of the Single Group-Wide Solvency and Financial Condition Report of the Company as at 31 December 2016, (**‘the Narrative Disclosures subject to audit’**); and
- Group templates S.02.01.02, S.22.01.22, S.23.01.22, S.25.01.22 and S.32.01.22 (**‘the Group Templates subject to audit’**).
- 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 in respect of Liverpool Victoria Friendly Society Limited
 - S.02.01.02, S.12.01.02, S.23.01.01, S.25.01.21 and S.28.01.01 in respect of Liverpool Victoria Life Company Limited
 - S.02.01.02, S.17.01.02, S.23.01.01, S.25.01.21 and S.28.01.01 in respect of LV Protection Limited and Teachers Assurance Company Limited
 - S.02.01.02, S.12.01.02, S.17.01.02, S.23.01.01, S.25.01.21 and S.28.01.01 in respect of Liverpool Victoria Insurance Company Limited and Highway Insurance Company Limited

(‘the Company Templates subject to audit’)

The Narrative Disclosures subject to audit, the Group Templates subject to audit and the Company Templates subject to audit are collectively referred to as the **‘relevant elements of the Single Group-Wide 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:

- The ‘Summary’, ‘Business and performance’, ‘System of governance’ and ‘Risk profile’ elements of the Single Group-Wide Solvency and Financial Condition Report;
- Group template S.05.01.02 and Company templates:
 - S.05.01.02 in respect of Liverpool Victoria Friendly Society Limited, Liverpool Victoria Life Company Limited, LV Protection Limited, Teachers Assurance Company Limited, Liverpool Victoria Insurance Company Limited and Highway Insurance Company Limited
 - S.19.01.21 in respect of LV Protection Limited, Teachers Assurance Company Limited, Liverpool Victoria Insurance Company Limited and Highway Insurance Company Limited

- 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 Single Group-Wide Solvency and Financial Condition Report (**'the Responsibility Statement'**);
- Information which pertains to an undertaking that is not a Solvency II undertaking and has been prepared in accordance with PRA rules other than those implementing the Solvency II Directive or in accordance with an EU instrument other than the Solvency II regulations (**'the sectoral information'**) as identified in the Appendix to this report.

To the extent the information subject to audit in the relevant elements of the Single Group-Wide 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 Single Group-Wide Solvency and Financial Condition Report of the Company as at 31 December 2016 is prepared, in all material respects, in accordance with the financial reporting provisions of the PRA Rules and Solvency II regulations on which they are based, as modified by relevant supervisory modifications, and as supplemented by supervisory approvals.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) (ISAs (UK & I)), International Standard on Auditing (UK) 800 and International Standard on Auditing (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 Single Group-Wide Solvency and Financial Condition Report* section of our report.

Emphasis of Matter - Basis of Accounting

We draw attention to the 'Valuation for solvency purposes' and/or 'Capital Management' sections of the Single Group-Wide Solvency and Financial Condition Report, which describe the basis of accounting. The Single Group-Wide 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 Single Group-Wide 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 Single Group-Wide Solvency and Financial Condition Report may not be suitable for another purpose. Our opinion is not modified in respect of this matter.

Responsibilities of Directors for the Single Group-Wide Solvency and Financial Condition Report

The Directors are responsible for the preparation of the Single Group-Wide Solvency and Financial Condition Report in accordance with the financial reporting provisions of the PRA rules and Solvency II regulations which have been modified by the modifications, and 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:

Modifications

- Permission to publish a Single Group-Wide SFCR in respect of Liverpool Victoria Friendly Society Limited, Liverpool Victoria Life Company Limited, LV Protection Limited, Teachers Assurance Company Limited, Liverpool Victoria Insurance Company Limited and Highway Insurance Company Limited

Approvals for LVFS limited (Society and Group) to apply the following:

- Approval to use the matching adjustment in the calculation of technical provisions
- Approval to use the volatility adjustment in the calculation of technical provisions
- Approval to use the transitional measure on technical provisions

The Directors are also responsible for such internal control as they determine is necessary to enable the preparation of a Single Group-Wide 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 Single Group-Wide Solvency and Financial Condition Report

It is our responsibility to form an independent opinion, in accordance with applicable law, ISAs (UK & I) and ISAs (UK) 800 and 805 as to whether the information subject to audit in the relevant elements of the Single Group-Wide Solvency and Financial Condition Report 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. ISAs (UK & I) require us to comply with the Auditing Practices Board's Ethical Standard for Auditors.

An audit involves obtaining evidence about the amounts and disclosures in the relevant elements of the Single Group-Wide Solvency and Financial Condition Report sufficient to give reasonable assurance that the relevant elements of the Single Group-Wide Solvency and Financial Condition Report are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Directors; and the overall presentation of the relevant elements of the Single Group-Wide Solvency and Financial Condition Report. In addition, we read all the financial and non-financial information in the Single Group-Wide Solvency and Financial Condition Report to identify material inconsistencies with the audited relevant elements of the Single Group-Wide Solvency and Financial Condition Report. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our 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.

Sectoral Information

In our opinion, in accordance with Rule 4.2 of the External Audit Part of the PRA Rulebook, the sectoral information has been properly compiled in accordance with the PRA rules and EU

instruments relating to that undertaking from information provided by members of the group and the relevant insurance group undertaking.

Other Information

In accordance with Rule 4.1 (3) of the External Audit Part of the PRA Rulebook for Solvency II firms we are required to read the Other Information and consider whether it is materially inconsistent with the relevant elements of the Single Group-Wide Solvency and Financial Condition Report and our knowledge obtained in the audits of the Single Group-Wide Solvency and Financial Condition Report and 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

London

21 June 2017

- The maintenance and integrity of the Liverpool Victoria Friendly Society Limited website is the responsibility of the directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditors accept no responsibility for any changes that may have occurred to the Single Group-Wide Solvency and Financial Condition Report since it was initially presented on the website.
- Legislation in the United Kingdom governing the preparation and dissemination of Solvency and Financial Condition Reports may differ from legislation in other jurisdictions.

Glossary

For convenience a number of defined terms are used throughout this document. These are set out below:

The Liverpool Victoria Group

Group / LV=	LVFS together with its subsidiaries
LVFS or Society	Liverpool Victoria Friendly Society Limited
LVIC	Liverpool Victoria Insurance Company Limited
LVLC	Liverpool Victoria Life Company Limited
Highway	Highway Insurance Company Ltd

LVPL	Liverpool Victoria Protection Limited
SBU	Strategic Business Unit
ExCo	The executive management committee of the Group established by the CEO
TAC	Teachers Assurance Company Ltd

Other terminology

ABE	Actuarial Best Estimate
BEL	Best Estimate Liabilities
CEO	Chief Executive Officer of the Society and the Group
CoC	Cost of Capital
CRO	Chief Risk Officer of the Society and the Group
Delegated Acts	Refers to Commission Delegated Regulation (EU) 2015/35 of 10 October 2014 unless another Delegated Regulation is specified
DTA	Deferred Tax Asset
DTL	Deferred Tax Liability
EIOPA	The European Insurance and Occupational Pensions Authority
ESG	Economic Scenario Generator
GAR	Guaranteed Annuity Rate
GI	General Insurance
IFRS	International Financial Reporting Standards
LAPSO	Legal Aid, Sentencing and Punishment of Offenders Act 2012
MA	Matching Adjustment
MAP	Matching Adjustment Portfolio
MCR	Minimum Capital Requirement
MIB	Motor Insurance Bureau
NED	Non-Executive Director

NNEG	No Negative Equity Guarantee
OB	Ordinary Business
Ogden discount rate	The discount rate is used to calculate lump sum settlements of bodily injury claims, including loss of earnings and ongoing medical care.
ORSA	Own Risk and Solvency Assessment
PRA	Prudential Regulation Authority
PWC	PricewaterhouseCoopers, LLP
PPO's	Permanent Payment Orders
QRTs	Quantitative Reporting Templates
RFF	Ring Fenced Fund
RNPFN	Royal National Pension Fund for Nurses
SCR	Solvency Capital Requirement
SF	Standard Formula
SFCR	Solvency and Financial Condition Report
SII Directive	Refers to Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) unless another Directive is specified
TA Fund	Teachers Assurance Fund
TMTTP	Transitional Measures on Technical Provisions
TPS	Teachers Provident Society (a RFF)
UK	United Kingdom
VA	Volatility Adjustment

Executive Summary

Background

The SFCR has been completed in accordance with the Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009, the Commission Delegated Regulation (EU) 2015/35 of 10 October 2014, the relevant Commission Implementing Regulation (EU), EIOPA's guidelines on reporting and the PRA rulebook.

The SFCR has been prepared on a Standard Formula basis for the Group, Society and its insurance subsidiaries. On 18th December 2015, LVFS was granted approval by the PRA to produce a single Group SFCR. Article 365 of the Delegated Regulations specify the reporting requirements of the Single Group SFCR report. The information reported at Group level is included in the main body of this report, and information related to the regulated subsidiary companies within the Group are included within the appendices.

Relevant information about the business of the Society and the Group is also provided in the Annual Report and Accounts for the year ended 31st December 2016 (the 'Report and Accounts'), a copy of which can be found at <https://www.lv.com/about-us/company-information/returns/reports-accounts>.

LVFS is the UK's largest friendly society, with more than five million members and customers. We exist to grow the value of our business for the benefit of our members.

Throughout our 170 year history, our focus on the customer has been key to the products and services we have offered and is the guiding principle behind the on-going success of the Society today. To achieve this we aim to put the customer at the centre of everything we do and live by our three brand promises:

- Easy to do business with
- Great value
- A caring approach

LVFS was founded in 1843 and the guiding principles left by our founders can still be recognised in our business today. Our goal then was to give financial security to more than just a privileged few and for many decades we were most commonly associated with providing a method of saving to people of modest means. Today we follow a similar principle, helping people to protect and provide for the things they love, although on a much larger scale and through a wide range of financial services including insurance, investment and retirement products.

We offer our services direct to consumers, as well as through independent financial advisors and brokers, and through strategic partnerships with a wide range of organisations. We also own a number of other financial brands including Britannia Rescue, Highway Insurance and Frizzell.

Business and Performance

The Group reported an IFRS loss before tax, mutual bonus and unallocated divisible surplus transfer of £49m for the year (2015 profit £124m). This reflected the impact of the Ogden rate change of £139m. The result benefited from good trading profits in both the general insurance and life businesses. At a group level the result included a £35 million operating loss in the heritage business generated by changes made to the reserving assumptions, partially reversing the £88 million operating profit in 2015.

System of Governance

There have been no significant changes in the Society's system of governance in the year. The table below summarises the changes in membership of the Board in the year:

D Barral – appointed 7 th March 2016
J O'Roarke resigned from the Board on 5 th May 2016.
S Treloar - appointed 5 th May 2016
M J Rogers - resigned 28 th July 2016.
R Rowney – (previously managing director life and pensions) appointed as CEO 28 th July 2016

Changes in legal and regulatory environment

Following publication of final guidance, FCA have finalised their expectations of firms treating long standing customers. The FCA is of the view that the industry has not delivered to customer expectations, and as a result all firms will need to review their processes and communications thoroughly to ensure ongoing compliance with their requirements. LV= has a well-established project that has clarified the ongoing activity required and estimated the cost of this activity, including the delivery of the programme of changes as well as the cost of remediating customers as appropriate. However, there is a risk that there is further remediation work not currently identified. The Society has been reviewing legacy products for a number of years and has made a number of changes in the past to improve the treatment of these customers so assesses this risk as low.

As a result of pensions freedoms, the Society has seen an increased demand for customers seeking to leave defined benefit schemes in favour of the more flexible benefits now available in defined contribution arrangements. The Financial Advice business (FAS) is operating in this market under strict controls, as this activity is high risk. The FCA have commenced a thematic review into this activity, in which LV= is participating, which could result in a change in regulatory requirements.

Risk Profile

LV= offers a range of products across both Life and General Insurance business lines. These cater to differing policyholder needs and a widely diversified customer base in terms of age, gender and geographical location.

The Society manages the risks ongoing from its business using a range of techniques, including EIOPA (European insurance regulatory body) prescribed “Standard Formula” (SF) capital calculations and internal views of risk and sensitivity testing. A number of Committees, such as Group Executive Risk Committee, Group Asset Liability Committee and Group Valuation and Internal Model Committee, attended by senior stakeholders, meet regularly to consider the Society’s risk exposure, and whether it is in line with Risk Appetite. This enables informed decision making on where risk mitigation is required, or where further risk can be taken on. Regular reports are made to the Prudential Regulation Authority (PRA), part of the Bank of England.

The Society’s risk profile and capital position were significantly affected in the year by volatility in long term interest rates and the spread between gilts and swap rates, particularly after the result of the EU Referendum. As a result the Society has put in place a number of interest rate and basis risk hedges to manage these risks and to protect its capital position. The Society also put in place reinsurance to reduce its exposure to longevity risk in enhanced annuities and OB Pensions. In addition the Society took the decision in the second half of the year to cease writing enhanced annuities, a capital consumptive product.

Valuation for Solvency purposes

For solvency valuation purposes, assets, technical and other liabilities are valued in accordance with Solvency II directive.

Assets and other liabilities represent the fair value amount for which they could be exchanged between knowledgeable willing parties in an arm’s length transaction and as such most assets measured at fair value are based on quoted market price or using quoted prices for similar assets in an inactive market or other observable inputs. The assets valued using quoted market prices for identical or similar assets from an inactive market fall under alternative methods for valuation under Solvency II. The assumptions and methods used can be found in section D of the Group report.

Although the Solvency II hierarchy is mapped differently, the methodology for valuing assets and other liabilities measured at fair value is the same.

Capital Management

At 31st December 2016 the Group capital surplus on a standard formula basis was £369m (a CCR of 135%) compared to £383m as at 1st January 2016 (CCR of 142%).

Since 1st January 2016, the group has operated on a Standard Formula basis for calculating its regulatory capital position. The group has continued to work closely with the PRA throughout 2016 to prepare an application to operate on an Internal Model. In July 2016, the PRA confirmed that the group’s preparations for Internal Model were sufficiently advanced to allow it to proceed to making an application for Model approval. LV= submitted an application for Internal Model approval in the first quarter of 2017. Internal Model will only be implemented following PRA review and approval.

The group secured PRA approval in April 2016 to apply the Matching Adjustment to the majority of its annuity business. The inclusion of the Matching Adjustment forms an integral part of the Group’s approach to Asset and Liability Management.

The Group has also received PRA approval to apply Transition (also known as Transitional Measure on Technical Provisions or TMTP) and Volatility Adjustment from 1st January 2016. Transition provides firms with relief from day 1 from the financial impact on Technical Provisions of moving to the new Solvency II regime. The relief then amortises annually over 16 years. The PRA also allows firms to apply for permission to recalculate Transition, subject to certain trigger conditions, to take account of matters such as market movements or changes to a firms' risk profile.

The group applied to and was granted by the PRA permission to recalculate Transition as of 29th April 2016, triggered by the move to use the Matching Adjustment, and as of 31st August 2016 due to changes in the business risk profile.

There was also an industry-wide recalculation on 30 June 2016 as a result of market movements. The net effect of the recalculations in the year has been to offset the adverse impacts of changes in business risks, including interest rates, on eligible own funds by some £281 million.

GROUP SFCR

A. Business and Performance (LV Group)

A.1 Business

a) Name and legal form of undertaking

Liverpool Victoria Friendly Society Limited is a UK-incorporated and domiciled Friendly Society registered under the Friendly Societies Act 1992. LVFS is the ultimate parent of the LV= Group of companies.

Registered office:
County Gates
Bournemouth
BH1 2NF
Telephone: 01202 292333

b) Name and contact detail of the supervisory authority responsible for financial supervision.

The Prudential Regulation Authority is responsible for the financial supervision of the company, and the Group.

Address: 20 Moorgate
London
EC2R 6DA
Phone: 020 7601 4444
Website: www.bankofengland.co.uk/pru

c) Name and contact details of the external auditor

The independent auditors are PricewaterhouseCoopers LLP

Address: 7 More London Riverside
London
SE1 2RT

d) Description of the holders of qualifying holdings in the undertaking

As LV= is a mutual organisation, there are no external qualifying holdings within the meaning of the Solvency II regulations. The ultimate parent company for all of the subsidiary companies within the group is LVFS.

e) Details of the undertakings within the group

The material subsidiary undertakings of the Group as at 31st December 2016 are as follows:

Name of Subsidiary	Principal activity	Percentage held
Frizzell Financial Services Limited	Property management	100%
Highway Insurance Company Limited * #	General insurance	100%
Highway Insurance Group Ltd *	General insurance holding company	100%
Liverpool Victoria Financial Advice Services Limited	Financial advice services	100%
Liverpool Victoria General Insurance Group Limited *	General insurance holding company	100%
Liverpool Victoria Insurance Company Limited * #	General insurance	100%
Liverpool Victoria Life Company Limited #	Life insurance	100%
Liverpool Victoria Portfolio Managers Limited	Investment management	100%
LV Protection Limited #	Insurance	100%
LV Capital PLC	Holding company	100%
LV Equity Release Limited	Equity release lifetime mortgages	100%
LV Insurance Management Limited*	Management services	100%
LV Life Services Limited	Management services	100%
LV Assistance Services Limited *	Road Rescue - Pay on use	100%
LV Commercial Mortgages Limited	Commercial mortgages	100%
NM Pensions Trustees Limited	Self-invested personal pension (SIPP)	100%
LV Repair Services Limited *	Repair Services	100%
Wealth Wizards Limited	IT Software	70%
Wealth Wizards Benefit Limited *	Financial intermediary	100%
Wealth Wizards Advisers Limited *	Financial intermediary	100%
Teachers Assurance Company Limited #	General insurance	100%

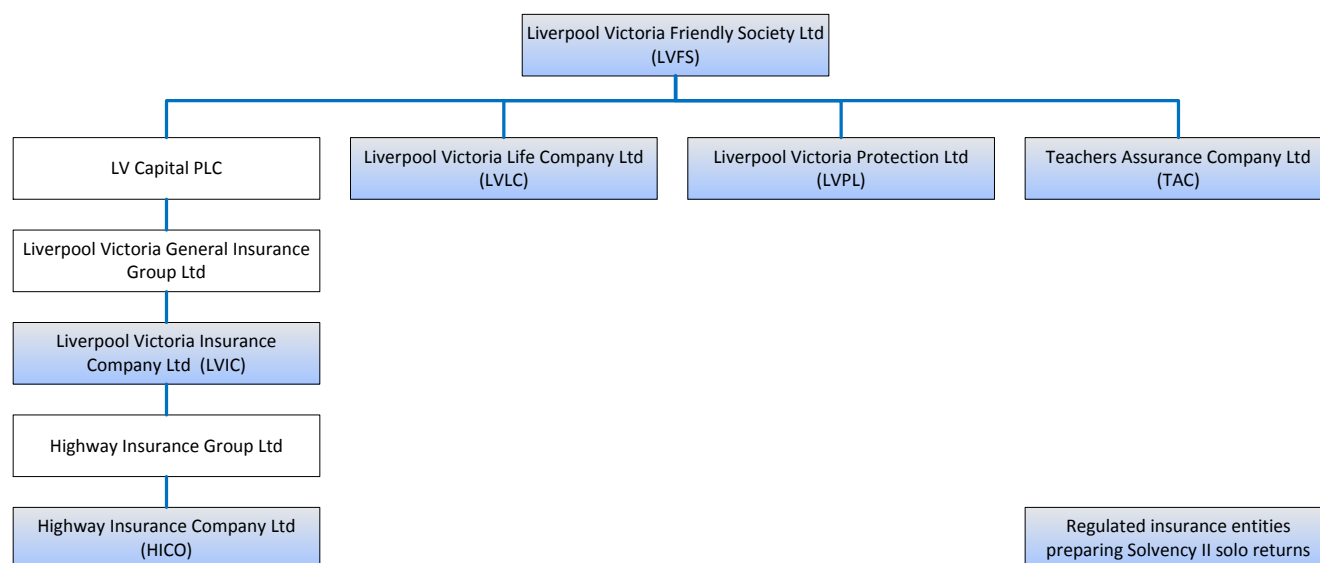
* Denotes indirect holdings

Denotes Solvency II regulated undertakings

The proportion of the voting rights in the subsidiary undertakings held directly by the parent company do not differ from the proportion of ordinary shares held.

The Group and all principal undertakings incorporated and domiciled in the UK. All holdings are in relation to ordinary shares. Dormant companies have been excluded from the above list but are included in the QRT S.32.01.22.

The following is a simplified extract of the LVFS corporate structure chart, showing the positions of the material Solvency II solo entities within the Group structure:



The group prepares its financial statements on an IFRS basis, which presents the parent company and all subsidiaries on a consolidated basis.

Under Solvency II, the non-insurance regulated entities are not consolidated but are accounted for as investments in participations.

f) Material lines of business and material geographic areas.

The Group underwrites both life and non-life insurance contracts within the UK. There is a small amount of non-life business written in the Republic of Ireland by Highway Insurance Company; however this is not material to the Group or Highway Insurance Company and will therefore not be reported separately in any QRTs requiring splits by country.

General insurance:

The principal activity is to underwrite general insurance business through both direct and broker distribution channels. The primary sources of premium income are from the sale of Motor and Home products and Commercial Insurance for small and medium size enterprises. The General Insurance business also underwrites Pet Insurance and Travel Insurance.

Life:

The principal activity is the provision of protection and retirement solution products. The core products offered in protection are Life, Critical Illness, Income Protection and Unemployment Insurance while the core products offered in retirement solutions are annuities, self-invested personal pensions (SIPPs), equity release mortgages and flexible guarantee bonds.

Heritage:

This segment focuses on savings and investment products that are no longer actively marketed, the majority of these being with profit products.

a) Significant business or other events occurring during the reporting period that have a material impact on the undertaking.

LVFS completed its acquisition of Teachers Assurance business on the 1st June 2016. This included the transfer of life insurance business into LVFS and the acquisition of a small non-life insurance subsidiary as well as some non-insurance subsidiary companies. The with profits business has been set up as a ring fenced fund.

On 23rd June 2016 a referendum took place in which the UK voted to leave the EU. As the Group materially sells and underwrites policies to UK residents the impact of the referendum is not expected to significantly impact the Group. However, there is a level of uncertainty as to how future legislation will be changed to allow the UK to keep its trading relationship with the EU and the impact on the UK economy. The Group will continue to monitor the impact carefully. Following the referendum result there was considerable volatility in markets, particularly in interest rates.

On 27th February 2017 the Ministry of Justice announced a reduction in the discount rate to be applied in calculating personal injury damage awards (“Ogden rate”) from 2.5% to minus 0.75%. This change impacted the valuation of the cost of care element of large injury claims, and required insurance companies to hold more money in reserves in order to match the inflation risk in the long term. The impact of this Ogden change has led to an increase in bodily injury reserves of £139m for the Group and has significantly impacted other insurers in the market.

A.2 Underwriting performance

The following table provides further information on the material lines of business written during the reporting period:

LVFS Group	2016 – Life Lines of Business (£m)					
Life	Health insurance	Insurance with profit participation	Index-linked and unit-linked insurance	Other life insurance	Other expenses	Total
Net earned premiums	47	609	-	311	-	967
Net claims incurred including change in Technical Provisions	(19)	(1,170)	(345)	(596)	-	(2,130)
Expenses incurred (excluding investment management costs)	(47)	(20)	(21)	(81)	(29)	(198)
Total	(19)	(581)	(366)	(366)	(29)	(1,361)

LVFS Group	2016 – Non-Life Lines of Business (£m)							
GI	Motor vehicle liability insurance	Other motor insurance	Fire and other damage to property insurance	General liability insurance	Legal expenses insurance	Assistance	Other expenses	Total
Net earned premiums	683	211	206	19	23	50	-	1192
Net claims incurred	-582	-181	-128	-12	-2	-28	-	-933
Expenses incurred (excluding investment management costs)	-201	-62	-85	-9	-4	-12	-5	-378
Total	-100	-32	-7	-2	17	10	-5	-119

LVFS Group	2015 – Life Lines of Business (£m)							
Life 2015 (£m)	Health insurance	Insurance with profit participation	Index-linked and unit-linked insurance	Other life insurance			Other expenses	Total
Net earned premiums	44	421	-	338			-	803
Net claims incurred including change in Technical Provisions	36	(194)	(269)	(186)			-	(613)
Expenses incurred (excluding investment management costs)	(46)	(20)	(20)	(78)			(22)	(186)
Total	34	207	(289)	74			(22)	4

LVFS Group	2015 – Non-Life Lines of Business (£m)								
GI 2015 (£m)	Motor vehicle liability insurance	Other motor insurance	Fire and other damage to property insurance	General liability insurance	Legal expenses insurance	Assistance	Miscellaneous financial loss	Other expenses	Total
Net earned premiums	634	198	212	20	23	48	-	-	1,135
Net claims incurred	(398)	(125)	(140)	(13)	(1)	(24)	-	-	(701)
Expenses incurred (excluding investment management costs)	(234)	(73)	(95)	(10)	(4)	(16)	-	0	(432)
Total	2	0	(23)	(3)	18	8	0	0	2

All business is underwritten in the UK.

2016 has seen an increase in gross earned premiums of £352 million to £2,760million. The majority of this increase was in the life business, with strong new business sales across all life product categories. General insurance sales also increased quantity, with gross earned premiums up 8% by £100 million, mainly in motor insurance. The increase in gross earned premiums was mitigated at a net earned premium level by increases in reinsurance ceded. Additional reinsurance treaties have been introduced for annuities and a 20% quota share agreement put in place in the general reinsurance business as one of several management actions during the year to manage risk and protect the Solvency II capital position.

A.3 Investment performance

a) Income and expenses with respect to investment activities

Components of investment activities

Investment income and expenses are reported consistently with IFRS. Investment income includes dividends, interest from investments at fair value, interest on loans and receivables, interest on loans secured on residential and commercial property. Dividends are included on an ex-dividend basis.

Realised gains and losses on investments are calculated as the difference between net sales proceeds and purchase price.

Unrealised gains and losses on investments represent the difference between the valuation of fair value assets at the Statement of Financial Position date and their valuation at the last Statement of Financial Position date or, where purchased during the year, the purchase price. An adjustment is made to unrealised gains and losses for the prior year's unrealised element included in the current year's realised gains and losses.

Investment management expenses and charges are those other operating and administrative expenses which are directly attributable to investment activities.

Investment performance

The following table summarises the income and expenses with respect to investment activities, on an IFRS basis, during the last reporting period:

	2016 £m	2015 £m
Dividend income	107	96
Interest income	294	305
Net realised and unrealised gains/(losses)	1,006	(282)
Less investment management expenses	(21)	(22)
Total Investment Performance per IFRS	1,386	97

Investment income of £1,386m was £1,289m higher than 2015 driven by a £1,288m increase in realised and unrealised gains in the year in equities, government bonds and corporate bonds. This reflected reductions in gilt yields, which drove increases in the valuation of debt securities, and strong UK equity markets in particular.

The following table summarises the undertaking's overall investment performance on a Solvency II basis during the reporting period which provides more granular information by relevant asset class:

2016 Asset class (£m)	Dividends	Interest	Net gains and losses	Total	Percentage of Total	Average investment holding during 2016	Average investment return
Government bonds	-	71	269	340	24.3%	2,719	12.5%
Corporate bonds	-	128	100	229	16.3%	3,098	7.4%
Equity	52	-	117	169	12.1%	1,101	15.4%
Collective investment undertakings	71	-	468	539	38.5%	2,754	19.6%
Collateralised securities	-	9	15	24	1.7%	131	18.3%
Cash and deposits	-	3	1	4	0.3%	566	0.7%
Mortgage and Loans	-	44	76	120	8.6%	797	15.1%
Call & Put options, Swaps, Futures	-	-	(25)	(25)	(1.8)%	137	(18.2)%
Total	123	255	1,021	1,399			
Less investment expenses				(21)			
Net total				1,378			

The investment performance for the year is primarily driven by net gains on investments of £1,021m. Gains on equities and collective investment undertakings (classified as equity under IFRS) of £585m reflect the overall increase in the UK and overseas markets. Gains of £369m on debt securities reflected lower gilt yields.

The difference between IFRS and Solvency II net investment income total is primarily due to classification and presentational adjustments as well as differences in treatment of Collective Investment Undertaking management charges of £8m.

b) Gains and losses recognised directly in equity

No investment gains or losses were recognised directly in equity.

c) Information about any investments in securitisation

There is currently £8m held with one provider which has been classified as securitisation. This represents 0.07% of the total investments held at the end of 2016. The value of this investment class is monitored on a quarterly basis.

A.4 Performance of other activities

The results of other activities are as follows:

	2016 £m	2015 £m
Finance interest charge	(24)	(24)

LVFS issued fixed rate reset subordinated notes at par of £350m on 22nd May 2013. This debt has a maturity date of 22nd May 2043 but the issuer has the option to redeem the notes at the first call date of 22nd May 2023 and at five yearly intervals thereafter up to the maturity date

	2016 £m	2015 £m
Other Income - general	37	29

Other general insurance income is predominantly driven by interest amounts charged to policy holders who pay for their general insurance on a monthly basis compared to fully paying for the insurance at the time of purchase. It also includes profit share relating to the quota share arrangement. In addition there is credit hire Income received.

Leasing arrangements

Finance lease commitments

Finance lease commitments relate to a property with a remaining lease term of 24 years. The lease is on a fixed repayment basis and no arrangements have been entered into for contingent payments. The Group's obligations under finance leases are secured by the lessors' charges over the leased assets.

A.5 Any other information

No additional information is disclosed under requirement Article 293(5).

B. System of Governance (LV Group)

This section outlines how the Group is directed and controlled, and provides an overview of the Group system of governance. It also describes remuneration policy and practices, and adherence with the 'Fit and Proper Requirements', which is the regulatory standard required when appointing those who effectively run the Company or have other key functions.

The Board is committed to high standards of corporate governance, which it believes are critical to business integrity and performance. The Board believes that implementing an effective Risk Management System is fundamental to achieving these high standards, and this section also describes how this works in some detail.

The Group monitors and assesses its system of governance on an ongoing basis. There have been no significant findings in relation to the systems of governance during the reporting period. The Board has adopted a governance structure based on the principles and provisions of the Financial Reporting Council's UK Corporate Governance Code (the 'Code'). The Board has chosen to adopt early the April 2016 amendments to the Code. As a Friendly Society, we voluntarily comply with the Code and its principle of comply or explain. The Board has confirmed its compliance with the Code, with the exception of two decisions approved by the Board; to allow the Chairman to be a member of the Audit Committee; and for only the Chairman to stand for annual re-election at the Annual General Meeting. The Board believes that its practices are consistent with the principles of the Code and are appropriate and suitable and for the Society and its members.

B.1 General information on the system of governance

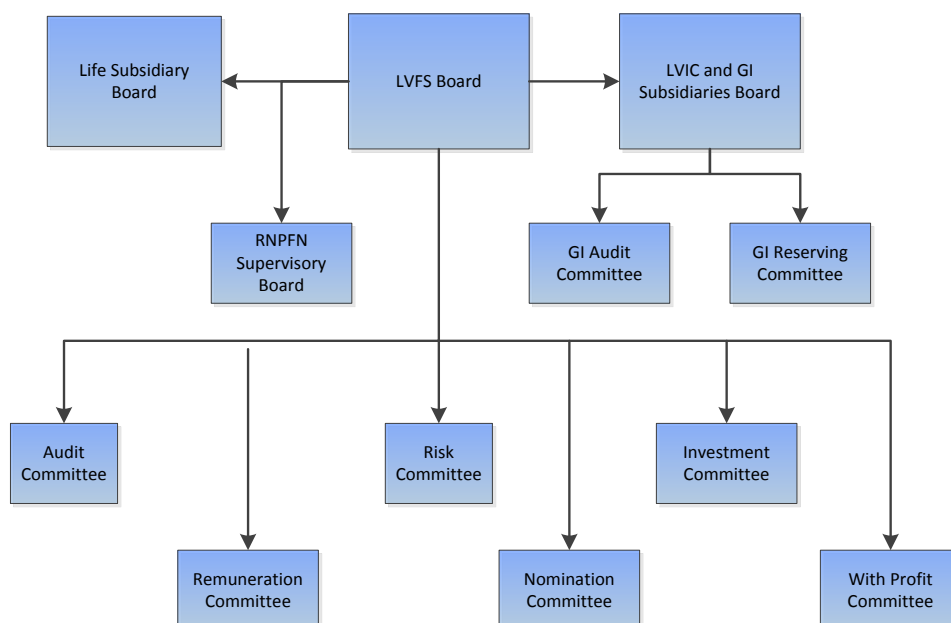
Governance structure

Liverpool Victoria Friendly Society (LVFS) is the ultimate parent undertaking of the Group. The LVFS Board is ultimately accountable to the Members (owners) of the Society and exercises stewardship over its subsidiaries through its right to appoint subsidiary Board members and through the reservation to LVFS of certain matters in the constitutions of subsidiaries (via their Articles of Association).

The LVFS Board comprises a non-executive chairman, five independent non-executive directors and four executive directors. Collectively they possess an appropriate balance of expertise in the financial services industry, including general insurance and life insurance, investments, risk and governance. This ensures a balance of skills, understanding and perspectives relevant to the Group's business.

In setting its governance arrangements, the LVFS Board either reserve decision making powers to itself, or delegate these powers either to a Board approved sub-committee or to the Group Chief Executive Officer. A full description of the Board's role and responsibilities is set out in the Board section (pages 76-89) of the 2016 Annual Report and Accounts. There have been no material changes to the system of governance during the reporting period.

The following chart illustrates the various committees of the Board and subsidiary Boards:



The LVFS Board have overall responsibility for the Group's risk management, internal control and reporting systems. Accordingly they ensure that Group-wide requirements across all these areas are set on a consistent basis. To support this, the Group has established key functions (set out in a Group Governance Map) that are responsible for managing and overseeing the application of these requirements across the Group.

Within its Systems of Governance, the key functions are Risk, Compliance, Actuarial and Internal Audit. In setting up these functions, the Board has ensured that:

- they are free from influences that may compromise their ability to undertake duties in an objective, fair and independent manner;
- each function operates under the ultimate responsibility of, and reporting to the Board;
- they have the necessary authority, resources and expertise, as well as unrestricted access to all relevant information necessary to carry out their responsibilities.

Each of these key functions has a Board approved Terms of Reference (ToR), setting out their scope, authority and an overview of objectives. The ToR also confirms how each function achieves independence, and how potential conflicts of interest are managed. The following table summarises the key roles and responsibilities for each function:

Risk Management function	Reporting to the Chief Risk Officer (CRO), the Risk Management function provides oversight as the second line of defence. Risk management works at a Group-wide level and is responsible for establishing an Enterprise Risk Management Framework (ERMF) which complies with external legal and regulatory requirements. The Risk Management function provides oversight and challenge to all material risk-based decisions. They also produce independent risk management reports for Risk Committees and the Boards. A detailed account of all Risk Management activity is provided in section B.3 below.
Compliance function	The Compliance Function reports to the CRO and is part of the second line of defence; providing advice, support and challenge to the first line of defence in respect of compliance issues. Further details of Compliance Function responsibilities and activities are included within section B.4 below.
Internal Audit function	Internal Audit act as the third line of defence, providing independent and objective assurance to the Group Audit Committee and Executive Management on the effectiveness of systems of risk management and internal controls across the organisation and its subsidiaries in order to mitigate key business risks and to assess the sustainability of the organisation. A detailed account of the function's operations and responsibilities is provided in section B.5 below.
Actuarial function	The actuarial function, which covers both Life and GI business, report to the CRO. Their key responsibilities include: <ul style="list-style-type: none"> • Providing oversight, challenge to and validation of the valuation of technical provisions, including over the internal controls in place; and • Reviewing underwriting and reinsurance policies and practices. Further details are provided in section B.6 below.

The Group has a Remuneration Committee consisting of four non-executive directors of the Society, at least three of which shall be independent non-executive directors. Its main responsibilities are to recommend to the Board the policy on the structure of remuneration across the Group, to determine the remuneration policy and packages for the senior executive population and to oversee the policy and governance of variable remuneration across the Group, including sales incentive schemes.

The Group Remuneration Policy is designed to support recruitment and retention of talented people who are able to achieve stretching targets and deliver greater benefits for the LV= members. It aims to provide remuneration packages that are positioned at the mid-point of the external market, and which have a significant proportion dependent upon the delivery of strong performance.

Remuneration arrangements, which are reviewed at least annually, must promote sound and effective risk management and not encourage risk-taking that exceeds risk appetite or limits. The Remuneration Policy aims to ensure that management are incentivised appropriately to support the short, medium and long-term interests of the LV= members.

The fixed and variable components of remuneration are determined by the Remuneration Committee. As a general rule, the more senior the role, the more pay is driven by performance based incentives. For all schemes, the Remuneration Committee seek to ensure that the components are balanced so that:

- the fixed or guaranteed component represents a sufficiently high proportion of the total remuneration;
- employees are not overly dependent on the variable components; and
- the arrangements allow the LVFS Group to operate a fully flexible bonus policy, including the possibility of paying no variable component.

For our Group Annual Bonus scheme, we operate a balanced scorecard of measures, with financial criteria accounting for 55% of the overall pot, and non-financial measures accounting for the remaining 45%. Risk is taken into account when assessing performance against all the measures in the balanced scorecard and the Remuneration Committee may reduce or cancel any bonus payment if it considers that risk exceeded acceptable levels.

We also operate a long-term incentive plan (LTIP), which applies to the Group Executive together with other key employees. The purpose of the LTIP is to focus performance on the achievement of longer term goals and so align the interests of key employees with Members and to retain key talent. LTIP performance conditions for 2017 awards will be based on performance over three years and measure Group adjusted average pre-tax profits and also Group relative investment performance for the Group Chief Executive Officer and Group Finance Director only. In determining whether financial targets have been achieved, the Remuneration Committee may, where appropriate, make positive or negative adjustments for the financial impacts of any management actions which affect the calculation of the adjusted earnings, to

ensure that the calculation is fully aligned to the interests of members. The Remuneration Committee also has discretion to defer, amend or cancel any payment in the event of any capital, liquidity or dividend policy commitments not being met. The Chief Risk Officer will provide advice to the Remuneration Committee on any use of this discretion.

For employees designated as Solvency II employees, in line with regulatory requirements, up to 60% of variable remuneration (bonus and LTIP) will be deferred. Where the proportion of variable remuneration required to be deferred is not met from LTIP alone, an appropriate proportion of annual bonus will be deferred. Deferred variable remuneration will be released in three equal tranches on the third, fourth and fifth anniversary of the original award date.

Full details of the principles of the Group's Remuneration Policy and practices, including those applicable to the directors of LVFS and subsidiary companies and other key function holders, are set out on pages 94-107 of the 2016 Annual Report & Accounts.

There were no material transactions during the reporting period with shareholders, with persons who exercise a significant influence on the undertaking, or with members of the administrative, management or supervisory body.

B.2 Fit and proper

The LVFS Group seeks to ensure that it only employs people of good repute and integrity, and who have the skills, experience and qualifications to meet the business and regulatory requirements of their role. Everyone employed by the Group must meet a set of mandatory requirements, as defined in the Group's Fit and Proper Policy and which are underpinned by the following principles:

- Honesty, integrity and reputation;
- Competency and capability;
- Financial soundness.

The policy establishes various procedures that must be followed both at the point of appointment and on an ongoing basis. This includes a standardised recruitment process, based on a consideration of factors including experience, skills, qualifications, behaviours and attitude. A Group Referencing Standard establishes the key checks to be performed to ensure that candidates meet the Fit and Proper requirements.

The consideration of an individual's fitness includes an assessment of their professional and formal qualifications, knowledge and relevant experience. It also considers the duties of the role and the skills of the person to fulfil those duties. The assessment of whether a person is proper must also include a review of their honesty and financial soundness based on evidence regarding their character, personal behaviour and business conduct including any criminal, financial and regulatory aspects.

In addition, key management personnel are aligned to the Senior Insurance Managers Regime. This includes Board members as well as Risk Management, Internal Audit, Compliance, Actuarial, the Money Laundering Reporting Officer and other roles seen as being a Significant Influence Function. Collectively, these personnel possess specific professional qualifications, experience and knowledge across multiple areas.

On an annual basis, we conduct an attestation exercise across all senior management including key function holders, as part of our ongoing work to assess their fitness, propriety and any potential conflicts of interest.

In addition, the performance of Board members is reviewed annually both individually and as a collective. The senior independent director, with the assistance of the non-executive directors and taking into account the views of the executive directors, reviews the performance of the chairman and the chairman reviews the performance of all other directors.

B.3 Risk management system

The LVFS Board bears ultimate responsibility for management of all risk across the Group and has established a consistent approach to be followed across all Group entities. In particular, the Board takes responsibility for:

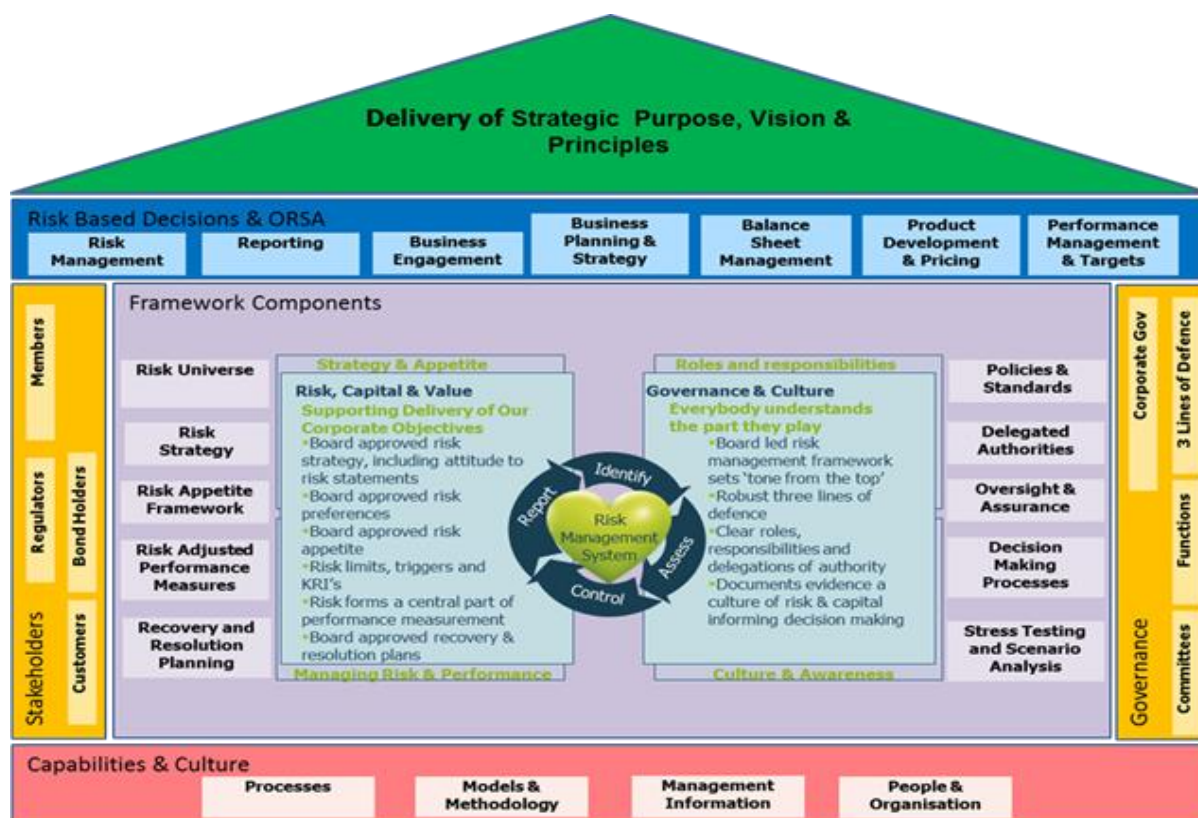
- approving the Group risk strategy and associated risk appetite statements;
- setting out a ‘three lines of defence’ model to be followed for risk management;
- monitoring the overall Group risk profile on a regular basis; and
- reviewing and approving the Group ORSA report.

This ensures that a robust and effective risk management framework is applied consistently, aligned with recognised good practice and with the nature and sophistication of the risks involved. Active monitoring and control is exercised across risks of all types, whilst maintaining compliance with all policies, appetite statements and regulations.

The LVFS Board delegates authority for oversight of risk management to the Risk Committee, who review regular reports on the effectiveness of risk management across the Group. In 2016, the Risk Committee commissioned an external review to provide additional insight, and initiated a Risk Development Programme to support the ongoing development of risk capability through 2017 and 2018.

Risk Management Framework

The Group operates an Enterprise Risk Management Framework (ERMF), which brings together risk management strategies, objectives, processes, and reporting procedures. This is represented in the following diagram:



The ERMF has been developed by Group Risk Management. It is reviewed at least annually, with changes approved by the CRO and the Risk Committee. The framework is centred on the traditional risk management processes of Identification, Assessment and Management. Key elements of the framework and its implementation are described further in the sections below.

Risk Strategy

The risk strategy comprises a set of statements which reflect the approach to risk and reward, and define the types of risks that the Group wants to accept or avoid. The statements defined at the Group level are listed below. In addition to these, in order to recognise the different risk factors associated with Life and Non-Life insurance markets, there are supplementary statements that have been tailored for each individual solo entity.

LVFS Group Risk Strategy Statements:

<i>Category</i>	<i>Risk Preferences</i>
Overall	We accept Group and Strategic risks as an inherent part of doing business, but aim to limit dependency on any one component of our strategy
	We have limited appetite for credit counterparty risk, but accept this risk selectively to optimise risk-adjusted returns
	We actively measure and manage financial and non-financial concentration risks due to their potential to cause unexpected sensitivities where unchecked
	Operational risks arise as a natural course of business however we aim to actively manage them in the interests of our brand and our members.
	We accept liquidity risk as a by-product of writing new business
Capital	Where in the estate we have enough capital to do so, we take additional financial market risk to generate better returns for members (not policyholders). However, we have no appetite to exceed the available capital in the estate, and will limit our market exposure should this become an issue.
Staff Pension Scheme	We take on financial market risk (equity, property, credit) to match our staff pension scheme liabilities, but aim to minimise the downside risk to LV where cost-effective.
	We seek illiquidity premium where this matches the term of our liabilities, and recognise this requires us to take some credit risk.
	We have little appetite for non-underwritten longevity risk within the staff pension scheme.
	We aim to maintain our expense risk exposure within the staff pension scheme at current levels as it is a by-product of running the SPS.

Risk Appetite and Limits

Risk appetite establishes the amount of various risk types that the Group is prepared to take. Risk appetite statements and limits have been developed at the Group level, and these are summarised below. Statements and limits for the Life and GI businesses are then developed to align to these.

- Financial strength – the Group will hold a level of capital surplus that is equivalent to being assessed as an S&P ‘A’ rated firm.
- Solvency strength – the Group has no appetite to breach the regulatory Minimum Capital Requirement (MCR) and is only prepared to breach the Solvency Capital Requirement (SCR) in the event of a severe financial market led scenario.
- Liquidity - the Group will hold sufficient liquid capital resources to ensure it can meet its liquidity requirements in both normal and stressed circumstances.
- Reputation and capability - the Group will seek to avoid risks that materially impair its reputation, while ensuring that its treatment of customers and its operational capabilities are designed to deliver fair customer outcomes.
- Stakeholder commitment - the Group will, in stressed market conditions and over a cumulative three year period, aim to generate sufficient profit after tax to meet its planned mutual bonus and debt interest payments without recourse to retained earnings.

Risk Monitoring and Reporting

Group Risk Management (GRM) maintains the risk management system, and oversees implementation of the requirements, using a consistent approach reinforced by a series of detailed policies and standards. All material risks to the achievement of business objectives are identified, assessed and managed.

The risk management system includes an operational risk register, financial risk register and a register of emerging risks. All identified risks are assessed for the scale, nature and likelihood of their impacts. In addition, any emerging risks are assessed for impact, likelihood and velocity to decide what level of on-going monitoring is required.

The risk profile is regularly reviewed by risk committees, which consider the exposure against risk appetite, limits and triggers on both a current and outlook basis. Any breaches are escalated to Group governance committees if appropriate. Where appropriate, risks are quantified in terms of capital. The Group Valuation & Internal Model Committee (GVIMC) ensures that the capital calculations accurately reflect the Group’s profile. At least quarterly, GRM assess the top emerging risks and verify whether any have become quantifiable. At this point, such a risk would come within the scope of risk

management, and an additional capital requirement may be identified.

Implementing Risk Management across the Group

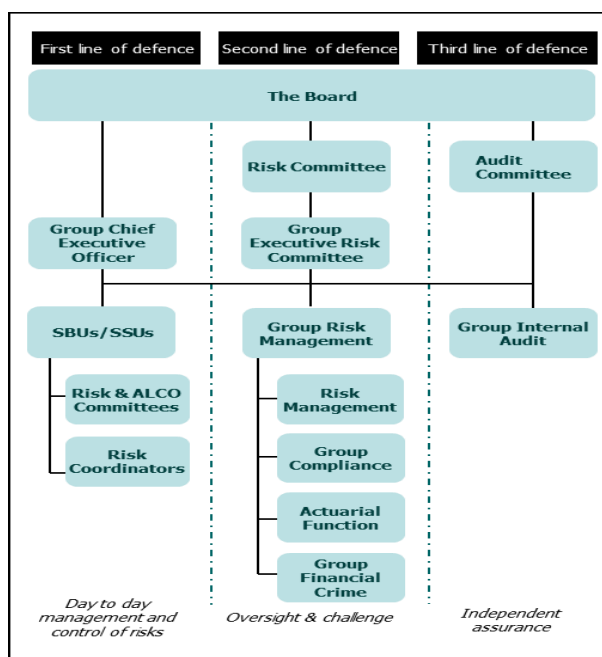
The LVFS Group aims to promote a culture of empowered risk-based decision making, safeguarded by appropriate challenge and escalation. Senior managers are required to maintain awareness of any potential risk or capital implications that could be significant for the Group. This is reinforced across the organisation through a robust governance framework and through role definitions.

GRM works with key stakeholders in decision making forums, to raise awareness and support the Group’s informed decision making. High level requirements for key decision making are included in a suite of risk policies, including consistency with the risk strategy and appetite, ensuring that any capital and solvency implications are assessed and monitored. All issues and exceptions are required to be escalated to the appropriate risk committee.

The ‘three lines of defence’ operating model that the Group has adopted for risk management maintains a clear distinction between:

- those who own and manage risk, i.e. those taking risks on behalf of the Group (First Line);
- those who provide the risk management framework, as well as objective oversight and challenge (Second Line); and
- those who provide independent assurance to the Board on the adequacy and effectiveness of the risk management and control frameworks in place (Second and Third Lines).

This is summarised in the chart below:



For every individual risk, there is a clear assignment of responsibility to a business area. Each Executive has primary accountability for ensuring that all material risks in their area are identified and managed within Risk Appetite, in line with the Group’s ERMF requirements. Each material risk has a designated risk owner, assigned by the Executive, who is responsible for ensuring it is monitored, managed and recorded appropriately.

Delegated Authorities are in place throughout the Company within specified limits. These are subject to annual review and are signed by the Group CEO and the respective Executives. Group Risk oversee the process and draft the Delegated Authorities to ensure they align with the committee TORs so that Executives are not given authority which should be exercised through a committee, or are out of line with Group Policies.

Risk Mitigation

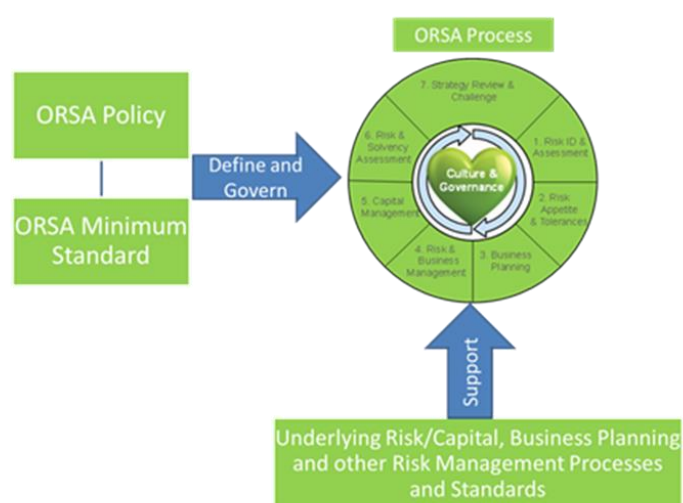
The Group aims to mitigate its risks to keep them within the agreed risk appetite by maintaining appropriate controls, engaging in relevant insurance/reinsurance, holding capital or entering into financial risk mitigation arrangements (such as derivatives). Any risk which cannot be maintained within risk appetite must either be avoided or escalated for formal risk

acceptance. Accepted “out of appetite” risks are subject to on-going monitoring and must be resubmitted for formal approval at least annually.

Own Risk & Solvency Assessment (ORSA)

The ORSA is an ongoing process by which the LVFS and solo entity Boards assess the respective risk and solvency positions both now and in the future; in making this assessment the ORSA considers the current and forecast business performance, risk profile and capital surplus. When the ORSA process is referenced, all of the risk management activities (whether BAU or one-off) are included. The ORSA is forward-looking, in that it considers the current LVFS Group business and risk profile as well the outlook for the plan and any anticipated external influences. The ORSA provides this assessment under different scenarios relative to the Board's appetite for risk and considers risk and solvency both from an economic view and by applying the regulatory requirements, should there be a material difference.

The ORSA approach is aligned to the Group’s Risk Management Framework. The design of the Group’s ORSA is shown in the diagram below and is applied across the Group so as to provide the appropriate level of insight.



The ORSA process is an iterative cycle of activities. Each activity comprises a number of established processes within the organisation. For example, the Risk Identification and Assessment activity is supported by: the regular identification and review of the principal risks; regular updates to the capital model and current and projected capital position; and product pricing reviews.

The ORSA Process involves a number of steps where senior management input is necessary. Iterating through these steps ensures that the ORSA features in business decisions. The output of these processes is reported within regular MI and committee papers. ORSA activity takes place throughout the year, with the latest assessment set out in Interim ORSA Reports (considered by the BRC and Board each quarter).

At least annually, a full ORSA must be undertaken, providing a current and forward-looking assessment of the Group’s risk, capital and solvency position. This will normally align with production of the business plan, and will result in an annual ORSA Report. This is a mandatory output, produced each time the ORSA process is completed. This assessment considers both the Group’s regulatory and economic capital position.

The ORSA Report consolidates the key outputs into a single report, and provides the Boards and management with a holistic, current and forward looking assessment of risks, capital and solvency. In this way, key findings, conclusions and recommendations can be understood and acted upon. The ORSA Assessment and accompanying Report are integrated into the organisational structure via regular reporting (including ORSA Reporting) and updates to key executive committees, and by the practice of designating named owners for ORSA recommendations. Key decisions (such as risk appetites, business Plans, and risk transfer) are made based on ORSA processes throughout the year, and the ORSA Report contains key recommendations which require Board-level decisions.

LV= has regulatory approval for the submission of a single Group ORSA report. This means that the outputs of the individual ORSAs conducted for each of the Insurance Entities, in addition to those of the LVFS Group, are documented together within the Group ORSA Report.

B.4 Internal control system

Internal Control encompasses all those systems that ensure that the organisation is managed efficiently and effectively, with appropriate policies and business processes to ensure achievement of business objectives. The Board is ultimately accountable for governance arrangements and for establishing an internal control system. Senior management is responsible for implementing this system across the LVFS Group.

The Group Internal Control Policy sets out mandatory internal control requirements, and defines an internal control system comprising a range of functions, roles and activities that represent an appropriate control environment for the business. When taken together, these define the processes that are in place to manage, control and monitor risks of all types, as well as the means of escalating and responding to alerts and indicators.

The internal control system enables the Group to operate efficiently and respond to any significant or evolving risks that could prevent or limit the achievement of its business objectives. The key functions that the Group has established for risk management, internal control and reporting, and the '3 Lines of Defence' model ensures that everyone in the Group is clear about their responsibility in relation to internal control activities.

The Compliance function is a fundamental element of the Second Line of Defence, with key compliance responsibilities included in the following roles, all of which report to the CRO:

- Director of Compliance – whose primary responsibilities relate to advising on conduct risk compliance and oversight of non-prudential regulatory change;
- Director of Risk – who is responsible for advising the CRO on compliance with risk matters, including the impact of regulatory change on the Group's risk profile; and
- Chief Actuaries – who are responsible for advising the CRO and the Director of Compliance on compliance with actuarial matters, including the impact of regulatory change on actuarial activities.

In addition, there is a Group Compliance team as part of the Second Line, that reports to the Director of Compliance and is responsible for designing and facilitating the implementation of the Regulatory Compliance Framework.

The Group Compliance Policy sets out mandatory requirements to reasonably assure that the Group remains compliant with the legal environment within which it operates, and remains within Risk Appetite. It includes the principles by which the compliance system is designed and operated, and sets out the key components of the system that support understanding and effective operation across the Group.

The policy is owned by the Director of Compliance, who is responsible for ensuring that it is produced and kept current and is reviewed by all SBUs and SSUs prior to formal approval submission. It is approved by the Board Risk Committee, with the CRO accountable for maintaining the policy content as well as supporting policies, processes and procedures.

The policy requires that Group Compliance implement and maintain a Regulation and Legislation Matrix which sets out individual departmental responsibilities for compliance. Each such department is required to:

- Establish a robust compliance system to identify and assess the impact of new requirements or changes to requirements in the Legal Environment;
- Advise the Board, Senior Management and other personnel regarding changes to the Legal Environment, as appropriate.

In addition, Group Compliance are responsible for developing and implementing:

- **Compliance Plan:** An annual compliance plan which oversees the implementation of changes to the Legal Environment and strategic priorities of the Compliance function, for review and approval by the Board Risk Committee;
- **Compliance Monitoring Plan:** An annual risk-based compliance monitoring plan which sets out the key independent assurance activities to be undertaken, for review and approval by the Board Risk Committee.

B.5 Internal audit

Group Internal Audit

Group Internal Audit (GIA) takes authority from the Group Audit Committee (GAC) through the GAC's approval of GIA's Charter and Annual Plan. The Internal Audit Director assesses whether the Internal Audit Charter is appropriate and in alignment with GIA objectives on an annual basis. The Internal Audit Director also communicates the result of this assessment to GAC in December of each year and seeks approval of the charter.

The Internal Audit Director is responsible for determining GIA's strategy and related programme of work so that management and the Board receive an appropriate level of objective and independent assurance coverage across the Group.

The scope of GIA's work is determined by the business strategy as well as an independent ongoing assessment of the key risks facing the Group and how well these risks are being managed. To provide this assurance, GIA determine, using a risk-based approach, whether assets, reputation and sustainability of the Group are being safeguarded; whether controls are in place and working effectively in accordance with Group policies and procedures as well as with applicable laws and regulations; and that records and reports of the Group are accurate and reliable.

GIA functions professionally, adhering to the Code of Ethics, Standards and Guidelines of the Institute of Internal Auditors (including the IIA guidance on Effective Internal Audit in the Financial Services Sector) and of other relevant professional bodies. It meets the requirements of the regulatory authorities in those areas upon which its work impacts.

GIA also liaise with External Audit on a regular basis to enable the external auditors to optimise their reliance on the work of GIA and to discuss issues emerging from their respective work.

Independence and Objectivity

GIA provides independent and objective assurance to the GAC and to Executive Management on the effectiveness of systems of risk management and internal controls across the organisation and its subsidiaries in order to mitigate key business risks and to assess the sustainability of the organisation, thereby assisting the GAC in meeting its statutory and regulatory reporting responsibilities.

The Internal Audit Director has a direct reporting line to the Chairman of the Audit Committee and Group CEO, and also has unrestricted access to the Chairman of the Board. The Chairman of the GAC and the Group Chief Executive approve jointly GIA resources and budgets.

In order to carry out their mission effectively, GIA have unrestricted access to the Group's records, including Board level information, personnel and premises to the degree necessary and relevant to discharge the Internal Audit Director's duties.

GIA, whilst consultative in approach, is free from influence in determining the scope of internal auditing, performance of work and communication of results. Any conflicts of interest that may influence objectivity or independence are disclosed and managed accordingly. GIA staff are at all times objective, constructive and not influenced by personal, business or other issues, which might impair impartiality. GIA has no direct operational responsibility or authority over any of the activities it reviews, nor does it perform any operational duties for the organisation other than the assurance work it undertakes.

An independent review of GIA effectiveness by a qualified, independent reviewer or review team from outside the organisation is conducted on a (minimum) 5 year cycle in accordance with CIAA standards and recognised best practice. The most recent review was conducted in 2015.

B.6 Actuarial function

The Actuarial Function forms part of the Second Line of Defence led by the Chief Risk Officer, who reports directly to the Group Chief Executive. It comprises the Life and GI Chief Actuaries.

The Actuarial Function provides oversight and challenge to the calculation of the technical provisions of the Group and reports to the relevant governance committees on the appropriateness of the methodologies, models, assumptions and data used. It also reports on the appropriateness of the underwriting, pricing, and reinsurance policies and arrangements applied.

The calculation of the Life Insurance technical provisions is performed by Actuarial Services, which sits within the Group Finance Function, reporting to the Group Finance Director, independently of the Chief Risk Officer. Actuarial Services propose the methodology and assumptions to use for the calculation of the technical provisions, which are then reviewed by the Life Chief Actuary and also by the Group Valuation and Internal Model Committee (GVIMC). The methodology, assumptions and results, along with the independent Actuarial Function review, are considered subsequently by the Audit Committee, before being recommended to the LVFS Board for approval.

The calculation of the GI technical provisions is performed by GI Actuarial Reserving, which sits within the GI Finance Function, reporting to the GI Finance Director independently of the Chief Risk Officer. GI Actuarial Reserving propose the methodology and assumptions to use for the calculation of the technical provisions, which are then reviewed by the GI Chief Actuary and also by the GI Reserving Committee. The methodology, assumptions and results, along with the independent Actuarial Function review, are considered subsequently by the LVGIG Audit Committee, before being recommended to the LVIC Board for approval.

The Actuarial Function also contributes to the oversight, challenge and validation of the Group Internal Model, including attendance at relevant committees. It provides advice and guidance to the Chief Risk Officer on the operation of the Risk Management Framework, especially the Capital Management Framework. This includes assistance with the oversight of risk exposures and advice on various capital management initiatives.

B.7 Outsourcing policy

To ensure a consistent approach across the Group, the Group maintains an Outsourcing and Sourcing Policy. This policy is reviewed on an annual basis and sets out detailed requirements on areas including:

- overall sourcing strategy ;
- supplier assessment criteria;
- principles for identifying Critical and Important relationships; and
- contractual and operational requirements and ongoing supplier relationship management.

Critical or important operational functions or activities which have been outsourced

In line with other large financial services organisations, the Group have a number of critical or important external suppliers and service providers. These provide support for asset management, IT application and maintenance, system hosting together with specialist support for our claims management capability.

These partners provide several benefits for the Group, including cost efficiency and access to improved technology within our administrative capability. Wherever processing or specialist work is undertaken by these partners, the Group remains fully responsible for the oversight, management and performance of the outsourced activity.

The nature of the services provided, and the jurisdictions they operate in, are listed below:

Description of Function or Activities	Jurisdiction of Service Providers
Investment of Group Assets, Investments in commercial mortgages	England and Wales
Infrastructure Management & systems development, Desktop services and Telephony	England and Wales
Outbound Printing and Inbound Scanning services	England and Wales
Software As A Service and Hosting arrangement	England, Wales and Scotland
Software and customer facing applications development	England, Wales and Scotland
Windscreen claims handling	England, Wales and Scotland
Customer fulfilment, marketing and communications templating	England, Wales and Netherlands
Out of hours home emergency cover	England, Wales and Netherlands
Legal Services	England and Wales
Claims processing software provider	England, Wales, Scotland and Northern Ireland
Approved Rates Provider	England, Wales, Scotland and Northern Ireland
Customer Payment Data Capture	England, Wales, Scotland and Northern Ireland

B.8 Additional information

There is no other material information on the Systems of Governance over and above that already described in the sections above.

C. Risk Profile (LV Group)

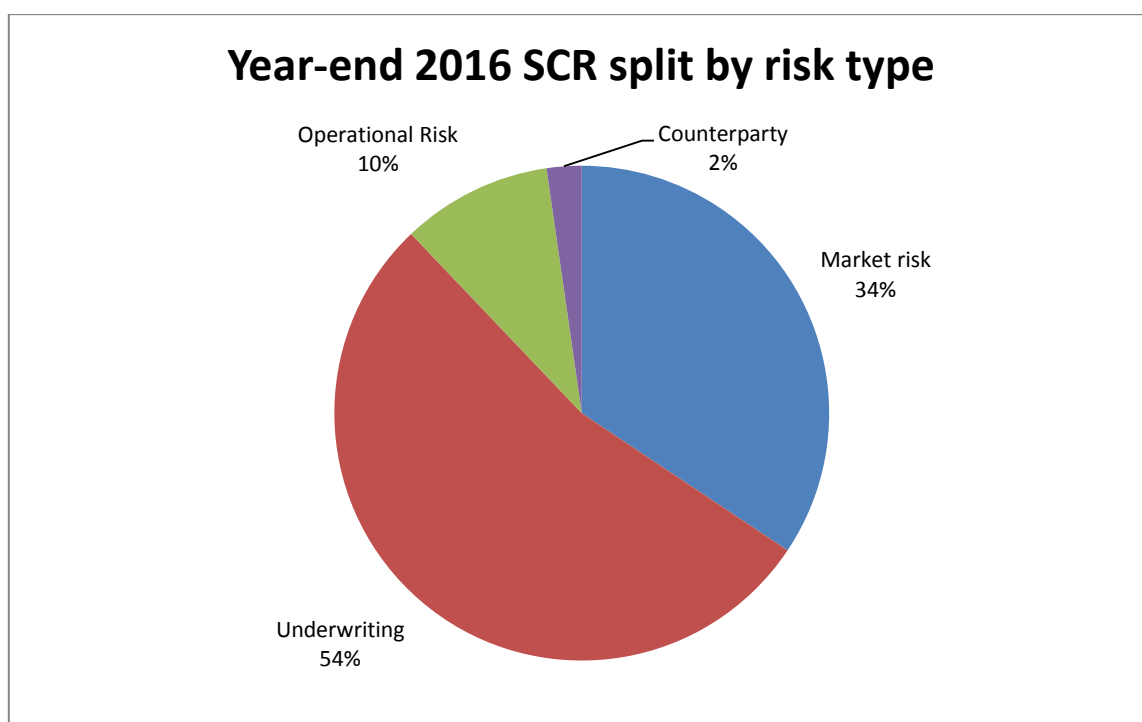
C.1 Overview

C.1.1 Overview of risk exposures

As an insurance company the Society's business model involves taking on risk for its policyholders, in order to provide security and aid in financial planning. In order to facilitate this LV= offers a range of products across both Life and General Insurance business lines. These cater to differing policyholder needs and a widely diversified customer base in terms of age, gender and geographical location.

The Society manages its risk using a range of techniques, including EIOPA (European insurance regulatory body) prescribed "Standard Formula" (SF) capital calculations, internal views of risk and sensitivity testing. A number of Committees, attended by senior stakeholders, meet regularly to consider the Society's risk exposure, and whether it is in line with Risk Appetite. This enables informed decision making on where risk mitigation is required, or where further risk can be taken on. Furthermore, external opinions are sought from consultancies and regular reports are made to the Prudential Regulation Authority (PRA), part of the Bank of England.

The chart below shows the year-end 2016 split of the Standard Formula Solvency Capital Requirement (SCR) by risk type. Reference to the SCR in this and later sections is to the final post-diversified SCR unless stated otherwise. The largest exposures relate to underwriting risk (54%) and market risk (34%).



C.1.2 Measurement of risk exposures

The Society measures its risk exposures using a variety of metrics. These metrics are reported to Senior Management including GVIMC, the Audit Committee, the Board, and in some cases the PRA. This allows Management to identify the key areas of risk exposure, and make informed decisions as to whether the current levels of exposure are consistent with the Society's Risk Appetite.

- Regulatory capital is measured using the Standard Formula approach prescribed by EIOPA, and reported to the PRA on a quarterly basis.
- LV= maintains its own internal view of capital measurement. This uses internal and local knowledge to assess risk in a more bespoke way than can be done using the Standard Formula approach.
- An analysis of change is performed on Own Funds on a quarterly basis for the Group and life entities, including evaluating how actual experience compares to the expected position. A full analysis of change is also performed on the capital requirements on an annual basis, looking at individual risks as well as the whole SCR.
- Capital and Own Funds are monitored using sensitivities and approximations on a regular basis, and the results reported to Senior Management. These results are then compared to actuals on a quarterly basis.

- Regular experience analysis is performed on key assumptions to evaluate their continued suitability. This includes both demographic experience and expenses.
- Stress and scenario testing is performed annually for the Own Risk and Solvency Assessment (ORSA) and business planning exercises.

C.1.3 Prudent person principle

LVFS and its subsidiaries operate within an investment framework which ensures that all assets are invested in accordance with the prudent person principle. The investment framework is suitably flexible to manage the different investment needs of the diverse business areas within the Group. All investment and strategic management decisions are set within Board approved risk appetite limits. Working within this risk framework, considerations of commerciality, treating the customer fairly and policyholders' reasonable expectations are embedded into the investment strategies for each business as appropriate.

All invested assets are managed by external investment managers under an investment management agreement (IMA). Within the IMA, there are a number of investment guidelines which reflect the risk appetite limits and investment management parameters. All investment guidelines are approved by the LVFS Board or a delegated authority of the LVFS Board.

Derivatives are used to manage risk and balance sheet volatility. All derivative strategies are approved by the relevant management or Board governance body.

C.1.4 Risk concentration

The Society offers a wide range of product options catering to differing policyholder needs and a widely diversified customer base in terms of age, gender and geographical location. As such, the Society has a diverse and balanced mix of business and risk exposures.

In addition, the Society uses a variety of measures to limit any excess concentrations:

- it invests in a range of assets governed by investment mandates and asset counterparty limits set by the Society;
- it uses a number of hedging and asset liability matching strategies to reduce market risk;
- it manages counterparty risk through risk limits on exposure and concentration; and
- it seeks to limit excess concentrations of underwriting risk through a range of reinsurance strategies.
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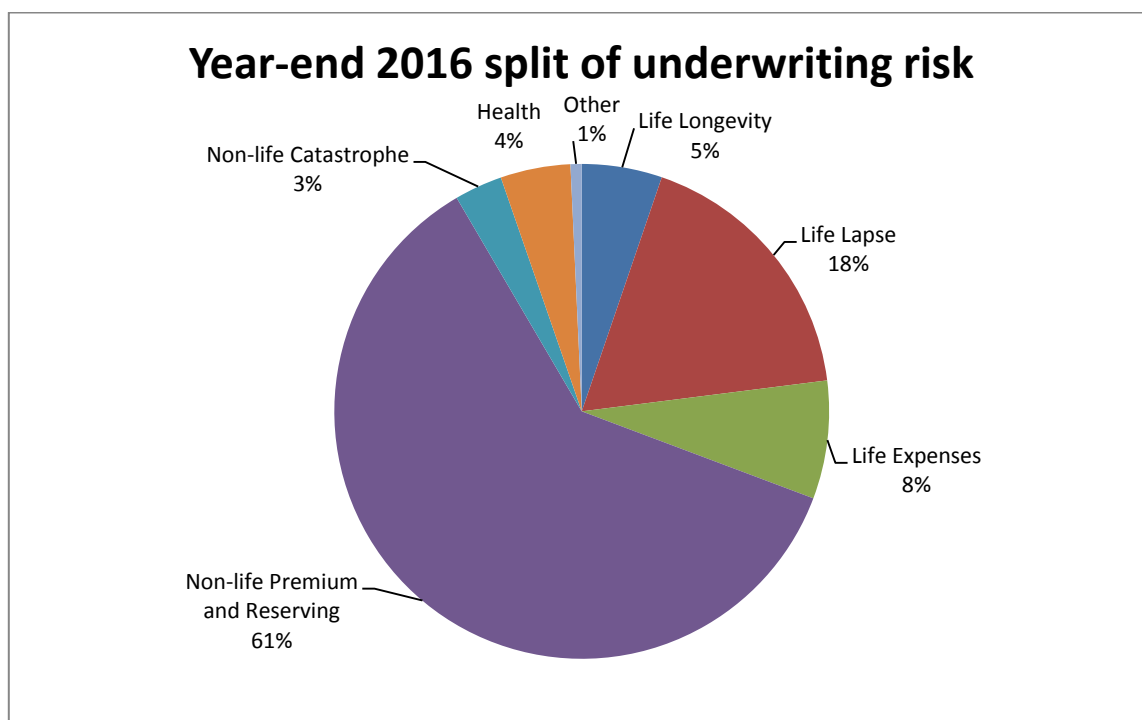
As the Group has substantially written all of its business in the UK, results are sensitive to demographic and economic changes arising in the UK.

Where material, further information on risk concentrations relating to particular risks is provided in sections C1 to C7. In addition, the appendices provide further information on specific risk concentrations that apply to individual entities of the Group.

C.2 Underwriting risk

C.2.1 Underwriting risk exposure

The Group is exposed to underwriting risks across life, health and non-Life business categories. The chart below shows the split of underwriting risks within the SCR at year-end 2016.



- The largest single risk exposure is in respect of non-life premium and reserving risk through the general insurance subsidiaries LVIC and Highway. This risk category represents the regulatory capital allocated in respect of motor and household insurance policies. The capital allocated covers general claims experience, but excludes the impact of natural disasters, covered under non-life catastrophe risk.
- Lapse risk is a significant issue across the life insurance industry, due to the long-term nature of the business. As a result, lapse rates on material product lines are closely monitored. By contrast, lapse risk on non-life business is a relatively small contributor to the overall capital requirement.
- Expense risk affects all business lines and covers the possibility of higher than expected expenses, for example due to higher than expected inflation.
- Longevity risk arises primarily from immediate and deferred annuities, partially mitigated by reinsurance. Periodic payment orders under non-life business are also included, these representing the award of an annuity to an individual following a motor insurance claim.
- All health exposure comes from protection products written in LVFS. Many of these products behave similarly to life insurance policies, but pay out on the diagnosis of a serious illness or on the loss of earnings due to illness. This category includes the risk of pandemics and the expense risk on health products.
- Non-life catastrophe risk mainly comes from the risk of windstorms, floods and other natural events liable to give rise to large volumes of claims in motor and household Insurance.
- The remaining risks include the risk of higher than expected mortality, life catastrophe risk such as a pandemic, and disability claims. These risks are relatively minor for the Society, being either small in nature, heavily reinsured, or heavily diversified against over sources of risk.

C.2.2 Material changes over the reporting period

Non-Life Underwriting Risk

The largest change in respect of the non-life business was the change to the Ogden discount rate prescribed by the Lord Chancellor from 2.5% to minus 0.75%. This parameter is used to assess serious injury compensation and resulted in a £139m increase in reserves and as well as associated capital requirements.

Life and Health Underwriting Risk

During 2016, the level of longevity swap cover on enhanced annuity policies was increased, leading to a significant fall in longevity risk over the period.

The movement in fixed-interest yields also had a significant impact on the risk profile. The sharp fall in interest rates, up to and following the announcement of the EU referendum result led to increases in the capital required for life underwriting risks particularly lapse risk.

C.2.3 Risk mitigation techniques

Reinsurance is used as a risk mitigation technique across a range of products to transfer mortality, morbidity, longevity, non-life liability and catastrophe risk outside of the Group. Reinsurance is used for various reasons including managing risks within appetite, capital financing, protection against large individual losses and access to expertise. The effectiveness of reinsurance is monitored through the review and approval of new reinsurance arrangements by the relevant governance committees, the ongoing monitoring of counterparty credit risk at the relevant governance committees, and the internal and external audit review of governance and processes.

C.2.4 Risk concentrations

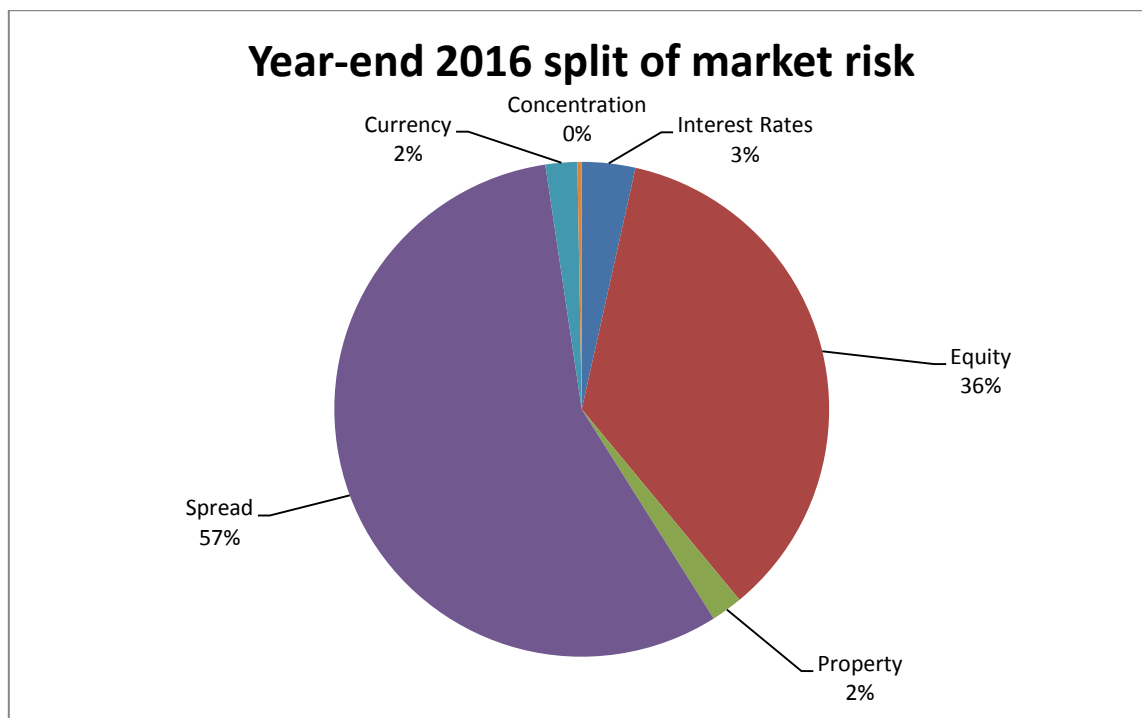
The Group has developed its insurance underwriting strategies to diversify the type of insurance risks accepted and, within each of these categories, to achieve a sufficiently large population of risks to reduce the variability of the expected outcome. The Group minimises the level of insurance concentration through the use of portfolio analysis and reinsurance. The Group is exposed to material changes in policyholder behaviour, for example through lapses, cash commutation and Guaranteed Annuity Option take-up rate. These risks are captured within the underwriting risk modules.

On the non-life side the Group is exposed to legislative changes which by their nature tend to impact whole sections of the business. Recent examples of these are LASPO, Ministry of Justice reforms and Ogden discount rate changes. These impacts are to some extent moderated by reinsurance.

C.3 Market risk

C.3.1 Market risk exposure

As an institutional investor, the Society invests in a range of assets, governed by mandates and limits set by the Society. The chart below shows the split of market risk within the year-end 2016 SCR.



The Society is exposed to the following material market risks:

- Spread risk is in respect of the yield above risk free paid by corporate bonds and similar investments. The Society has a large exposure to spread risk, arising primarily from the enhanced and fixed annuity business, where corporate bonds and equity release mortgages are used to back a large proportion of the liabilities. There is also a material contribution to spread risk from the defined benefit pension schemes, which invest a significant proportion of their assets in corporate bonds. As a major risk, spread risk is considered in more detail within the Group's internal view of risk, where alternative calibrations and approaches (such as looking at the yield of gilts above swaps) are considered.
- Equity risk arises primarily from the defined benefit pension schemes and the Group's with-profits business. For the pension schemes, investment returns have no direct impact on scheme members' benefits, so any reduction in equity values reduces surplus. For with-profits business, falls in equity markets increase the costs associated with guarantees.
- Interest rate risk is present under all lines of business, as the level of best-estimate liabilities are calculated by discounting future cashflows.
- Commercial property risk arises mainly from the with-profits business and from the Group's pension schemes. Residential property risk also arises from the Group's equity release mortgage portfolio though this is not reflected within the Standard Formula calculation of the SCR and is instead monitored using the Group's internal view of capital.
- Currency or foreign exchange risk. The Group has only a limited exposure to foreign exchange risk through its investment in overseas assets.

C.3.2 Material changes over the reporting period

In April 2016, the Group received PRA approval to use a matching adjustment for the annuity business held within a separate matching adjustment portfolio (MAP). The discount rate used to value the MAP annuity liabilities is aligned to the yield expected on the assets within the MAP (with an allowance for expected defaults and downgrades).

The approval for the use of a matching adjustment has reduced the Society's exposure to spread risk on corporate bonds due to linking the discount rate for the MAP liabilities with the asset yield. Offsetting this, there have been increases in spread risk over the reporting period from other factors including new business, the acquisition of the business from the Teachers Provident Society and market movements.

Equity risk has increased over 2016 due to a variety of factors, including: new business; a change in treatment of self-invested personal pension business; and increased exposure in the pension schemes and non-life subsidiaries. In addition, the Society chose to run off the transitional relief fully on the Type 1 equity stress used within the SCR calculation as, in the opinion of the Society, this better reflects its internal view of equity risk. A new equity hedging strategy has been implemented in 2017 to reduce equity risk in the non-life subsidiaries that is not reflected in the year-end 2016 results.

C.3.3 Risk mitigation techniques

LVFS uses derivatives as part of its management of market risk. Derivatives are currently used to manage interest rate risk and equity risk. These are described in more detail below.

Risk type	Description
Equity	Equity exposures across the Group are managed using portfolios of options and futures. The exposures under the with-profits business and within the general insurance subsidiaries are managed using options. The exposure associated with the annual management charges on unit linked business is managed using futures contracts.
Interest rates	A number of strategies are employed by the Group to manage interest rate risk. Interest rate swaps are used to improve asset liability matching across the Group, including that arising from the SCR and risk margin associated with the general insurance subsidiaries. A cash flow swap is used by the matching adjustment portfolio to facilitate strong cash flow matching on annuities business. A portfolio of interest rate swaption collars act to reduce the volatility of surplus capital to interest rate movements between the recalculation dates of the Transitional Measures on Technical Provisions. Gilt-swap spread risk, primarily resulting from holding long-term gilt assets to support deferred annuity business, is managed using over the counter hedging arrangements.
Inflation	Inflation exposure across the Group and within the defined benefit pension schemes are managed using inflation linked assets and inflation swaps.

C.3.4 Risk concentrations

Equity risk is managed by investing in a diverse portfolio of high quality securities, ensuring that holdings are diversified across industries. Concentrations in any one company or industry are limited by parameters established by the Investment Committee. The Group exposure to residential property risk arising from equity release mortgages, is managed through limits on the maximum loan to value ratio and seeking to limit concentrations in particular geographic areas.

C.4 Credit counterparty risk

C.4.1 Credit counterparty risk exposure

The principal risk that the Group is exposed to is the default of an external counterparty. This risk arises in a number of areas:

- The default of assets the Group has invested in, including derivatives. The default of reinsurers, to the extent that the reinsurer owes money to the Group. Given reinsurance is a key risk mitigant then any reinsurance default could seriously impact the Group's capital position.
- The default of insurance intermediaries on money owed to the Group.

Group policy and risk limits, are applied to credit counterparty risk, covering aspects such as the total exposure and concentration, and by taking action where necessary to avoid the limits being breached. Group counterparty exposures are monitored by the Group Asset Liability Committee. Reinsurance concentration risk is managed through contracting with a diverse range of reinsurers with credit ratings within an agreed risk appetite.

C.4.2 Material changes over the reporting period

There were no material changes to credit counterparty risk during 2016.

C.4.3 Risk concentrations

In order to limit its exposure to a single default, LV= monitors its concentration to individual counterparties on a quarterly basis. This enables management decisions such as investment strategy and reinsurance arrangements to be evaluated against the total exposure of the Group, and LV='s Risk Appetite.

C.5 Liquidity risk

Liquidity risk is the risk of having insufficient liquid assets to settle financial obligations when they fall due. Liquidity within the Group is maintained at a prudent level, with a buffer to cover contingencies including the provision of temporary liquidity to subsidiary companies. The Group does not hold capital for liquidity risk but has a liquidity risk appetite statement that requires sufficient liquid resources to be maintained to cover net cash outflows both on a business as usual basis and under stressed conditions. Adherence to the risk policy and monitoring of the liquidity cover ratio is performed by the Group Asset Liability Committee.

Liquidity risk is managed using several methods, these include:

- maintaining forecasts of cash requirements and adjusting investment management strategies as appropriate to meet these requirements, both in the short and long term;
- holding sufficient assets in investments which are readily marketable in a sufficiently short timeframe to be able to settle liabilities as they fall due;
- forecasting additional cash demands under stressed conditions, including demands for collateral, and identifying management actions to be taken to liquidate sufficient assets to meet the increased demands; and
- the appropriate matching of the maturities of assets and liabilities. The Group undertakes asset and liability management to ensure that the duration and term structure of liabilities is matched by the assets held to support them.

The expected profit included in future premiums (EPIFP) is the change in technical provisions, excluding risk margin, under the assumption that the premiums relating to existing insurance and reinsurance contracts that are expected to be received in the future are not received for any reason other than the insured event having occurred, regardless of the legal or contractual rights of the policyholder to discontinue the policy.

The expected profit in future premiums (EPIFP) for the Group at year-end was just over £266m.

C.6 Operational risk

Operational risk is the risk of loss arising from inadequate or failed internal processes, personnel or systems, or from external events. Operational risk arises as a natural consequence of business activity and is managed actively within LVFS.

As the operational risk capital requirements within the Standard Formula do not reflect the complexity of the actual Group risks, the Group also maintains a robust governance process and internal view of the risks it is exposed to. Senior management are responsible for ensuring that the material operational risks relevant to their area of responsibility are identified, assessed and then managed using the approach outlined in the Group's Operational Risk Policy. At least quarterly, each area must report its top risks and any controls in place to manage them. For material operational risks, regular scenario analysis is undertaken with due regard to all potential causes.

Further information on the categories of operational risk that the Group is exposed to and how these risks are managed can be found in the Risk Management section of the Annual Report and Accounts.

C.7 Other material risks

Capital requirements focus on known and quantifiable material risks. However some risks are not quantifiable, such as liquidity risk which is managed as described in section C5. In addition risks may arise from unknown sources. The Group therefore reviews its internal assessment of risk and capital on a regular basis to ensure that the best quality of information is available for decision making. Differences between the Group's internal view of capital and the regulatory view of capital includes a more in-depth view of certain risks such as spread risk, longevity and non-life risks, and the recognition of additional risks such as asset managers' discretion risk. An ongoing dialogue is maintained with the PRA, including regular submissions of our Own Risk and Solvency Assessment.

C.8 Sensitivities

This section sets out the Group’s sensitivity to various economic and demographic assumptions. Economic factors can have a material impact on both the assets and liabilities and therefore the sensitivity of the Group surplus capital to moderate movements in the factors is shown. The demographic sensitivities in contrast typically manifest themselves in a movement in just the liabilities and so the movement in the best-estimate liabilities to changes in the assumptions is shown. The movements in the demographic assumptions have been aligned to the 1-in-200 level assumed under the Standard Formula capital stresses and therefore represent a more extreme level of movement than the economic sensitivities that are also provided.

The sensitivities in this section show the impact of changes in key assumptions in isolation. In reality, there may be an interaction between the assumption and other factors. The sensitivities do not always behave in a linear way so using these sensitivities to assess a larger or smaller movement may not give an accurate result.

Further information can be found in the Capital and Risk Management section within the notes to the published Report and Accounts.

C.8.1 Economic sensitivities

The estimated impact on Group surplus capital to a range of economic factors is shown below. The estimates have been calculated on a Solvency II basis using a combination of analysis and expert judgement and include some approximations. Some limited allowance has been made for post-balance sheet events where these have a material impact. They should only be treated as estimates which give a broad indication of the direction and magnitude of the change in surplus capital in response to market movements.

The sensitivities assume that the Transitional Measures on Technical Provisions (TMTP) is not recalculated. In reality, if there were an extreme stress that caused a material change in the Society’s risk profile, then the TMTP might be recalculated (subject to the approval of the PRA), which could reduce some of the sensitivities shown.

Sensitivities		Impact
Item	Size	£m
Surplus capital at 31 st Dec 2016		367
Equities	10% market fall	(35)
Interest rates	25 bp fall	(39)
Interest rates	25 bp rise	37
Gilt swap spreads	25 bp rise	(51)
Credit spreads	50 bp rise	84

A more detailed description of each stress is given below:

- A fall in equity values reduces the value of the Group’s assets, including those in the defined benefit pension schemes. It also increases the with-profits liabilities due to higher guarantees costs.
- Sensitivities to changes in interest rates are applied to both swap and gilt rates. These stresses impact all fixed interest assets held by the Group such as government and corporate bonds. However they also impact the liabilities which are discounted using swap rates. Where the assets and liabilities are closely matched, these impacts broadly offset each other. However in other areas, such as the Risk Margin, there is no corresponding offset leading to a material sensitivity. The sensitivity to interest rates fell during 2016, due to the introduction of the MA, which reduced the exposure under the annuity business, and to other risk mitigation activity.
- Gilt swap spreads refer to the gap in yields between government bond and swaps. Many of the assets held by the Society are government or corporate bonds, and are therefore linked to gilt yields. In contrast, the liabilities are discounted using swap yields. A widening of gilt spreads, relative to swaps, therefore reduces the value of the Group’s assets by more than that of its liabilities. The exposure across the Group outside the pensions schemes to movement in gilt spreads is materially hedged using a derivatives contract.
- The widening of credit spreads is assessed relative to swap rates. This increases the value of the group’s defined benefit pension schemes, and reduces the value of those liabilities calculated using the Matching and Volatility Adjustments. These changes are partially offset by a reduction in the value of the corporate bonds held by the Group.

C.8.2 Demographic sensitivities

Life business

Demographic stresses relate to the behaviour and circumstances of policyholders. In pricing its products, the Group makes certain assumptions about how policyholders will behave, and how many policies will result in a claim under different policy conditions (such as accident, death and ill health). By their nature different products are affected differently by different demographic trends. For example protection products pay out on death, but annuity products pay an income until death.

The sensitivities shown below are in respect of the best estimate liabilities (outside the RNPFN and TA funds), allowing for the benefit of reinsurance, and only relate to those policies exposed to the relevant risk. So for example the mortality sensitivity assumes a 15% increase in the mortality of protection policyholders (and hence more claims). However, it does not allow for a 15% increase in the mortality rate of the annuitants which would increase surplus. They are therefore provided merely to illustrate the magnitude of any downside in extremely severe scenarios.

Sensitivities (relevant products only)		Impact	
Item	Size	£m	%
Best Estimate Liabilities (net of reinsurance)		12,811	
Mortality (products exposed to an increase in mortality rates)	15% increase in mortality rates	20	0.2%
Mortality (products exposed to a decrease in mortality rates)	20% decrease in mortality rates	109	0.8%
Lapses	50% increase in lapses	67	0.5%
Lapses	50% decrease in lapses	179	1.4%

A more detailed description of each stress is given below:

- The mortality stresses refer to the assumed rate of future mortality, and represent a percentage change in the volume of death claims. So for example if 1% of people are assumed to die per annum in the base case, 1.15% of people would die under the first stress, and 0.8% of people under the second. These stresses are aligned with those prescribed under the Standard Formula. For the increase in mortality the majority of the exposure comes from protection business, where claims are paid out on death. For the decreases in mortality the majority of the exposure comes from the deferred and in-payment annuities, where an income is paid on survival.
- The lapse stresses are calculated in a similar way. For example if 5% of policies are assumed to lapse in the base case then 7.5% would be expected to lapse in the 50% increase scenario. The lapse stresses are applied across all of the different types of surrender, including lapses and cash commutation rates. For the 50% increase stress the majority of the exposure comes from protection products, where the loss of future premiums more than offsets the reduced future claims. For the 50% decrease stress the majority of the exposure comes from the legacy with profit products where the guarantees are in the money.

Non-life business

Sensitivities for the non-life business are discussed in each of the LVIC SFCR and Highway SFCR, Section C6.

C.9 Additional information on risk profile

Further information on risk profile can be found in section C of the appendices for individual entities.

D. Valuation for Solvency Purposes (LV Group)

D.1 Assets

For solvency valuation purposes, assets and other liabilities are valued consistently with IFRS provided that IFRS valuation methods are consistent with Article 75 of Directive 2009/138. Assets and other liabilities represent the fair value amount for which they could be exchanged between knowledgeable willing parties in an arm's length transaction.

The financial statements for LVFS Group and its subsidiaries have been prepared in accordance with:

- International Financial Reporting Standards (IFRS), as endorsed by the European Union ('EU')
- International Financial Reporting Interpretations Committee ('IFRIC')
- Statement of Recommended Practice issued by the Association of British Insurers (2005), amended 2006
- (for LVFS) the Friendly Societies Accounts and Related Provisions Regulations 1994; and
- those parts of the Companies Act 2006 applicable to companies reporting under IFRS.

	Note	2016			
		IFRS	Presentational adjustments	Solvency Valuation adjustment	Solvency
Assets		£m	£m	£m	£m
Goodwill	1	220	-	(220)	-
Deferred acquisition costs	2	102	-	(102)	-
Intangible assets	1	71	-	(71)	-
Deferred tax assets	3	-	5	21	26
Pension benefit surplus	4	134	-	-	134
Property, plant & equipment held for own use	#	43	-	-	43
Investments (other than assets held for index-linked and unit-linked contracts)		13,037	(1,877)	-	11,160
Property (other than for own use)	#	5	-	-	5
Holdings in related undertakings, including participations	5,6	-	142	-	142
Equities	6	3,579	(2,707)	-	872
Bonds	6	5,829	842	-	6,671
Collective Investments Undertakings		3,200	(6)		3,194
Derivatives	7	179	-	-	179
Deposits other than cash equivalents	5	245	(148)	-	97
Assets held for index-linked and unit-linked contracts	8	-	2,001	-	2,001
Loans and mortgages	6,9	883	1	-	884
Reinsurance recoverables	10	1,090	562	(471)	1,181
Insurance and intermediaries receivables	11	265	-	(260)	5
Reinsurance receivables	#	28	-	(17)	11
Receivables (trade, not insurance)	#	46	(10)	-	36
Cash and cash equivalents	12	805	(630)	-	175
Any other assets, not elsewhere shown	13	146	(82)	-	64
Total assets		16,870	(30)	(1,120)	15,720

= Disclosure note not provided as solvency value equal to IFRS or the amounts are immaterial.

Supporting Notes

1. Goodwill and other intangible assets

For Solvency II valuation purposes, goodwill and other intangible assets are valued at nil.

Under Solvency II intangibles can only be ascribed a value when they can be sold separately and it can demonstrate there are quoted prices in active markets for same or similar assets. All intangible assets do not meet those conditions and therefore are ascribed a value of nil.

2. Deferred acquisition costs

For Solvency II valuation purposes, deferred acquisition costs are set to nil however the cashflows relating to DAC-able expenses, are included within the Technical Provisions valuation if they fall within the projected timeframes (see D2Technical Provisions).

Under IFRS, the proportion of the costs of acquiring new general insurance business which relate to unearned premiums are deferred and recognised as an asset to the extent that they are recoverable out of margins in future matching revenues.

Acquisition costs comprise all allowable costs incurred in writing new contracts. Deferred acquisition costs are amortised over a period which is consistent with the assessment of the expected pattern of receipt of future revenue margins for each product type.

All deferred acquisition costs are tested for recoverability at each reporting date. The carrying values are adjusted to recoverable amounts and any resulting impairment losses are charged to the Statement of Comprehensive Income.

3. Deferred tax assets

	£m
Deferred tax assets - IFRS	-
Presentational adjustment	5
Solvency valuation adjustment	21
Deferred tax assets - solvency valuation	26

Under IFRS a deferred tax asset arising in Highway is netted against deferred tax liabilities on the Group balance sheet. The recoverability of this DTA is based on Board Approved Business Plans and relates to tax losses carried forward of £22m. The DTA of £4m is carried forward to the Solvency II Base Balance Sheet.

There are a number of changes that need to be made to the LVIC and Highway IFRS Balance Sheet on the move to Solvency II which impact the Solvency II profit. A Deferred Tax provision is established to recognise the timing differences arising. These differences relate to the changes in the valuation of goodwill, intangible assets, reserves, insurance recoveries and payables and the value of sub-ordinated debt.

The impact of these changes is that there is a decrease in the taxable profits of LVIC and Highway of £117m. The recoverability of this DTA requires justification in the same manner as required for a DTA on the IFRS Balance Sheet. The recoverability of the losses arising from a move to Solvency II has been justified based on Board Approved Business Plans for LVIC and Highway. The reversal of the risk margin is not included in the profit projections.

The total tax loss of £139m (i.e. IFRS £22m plus Solvency II £117m) has been justified based on the Board Approved Business Plans over the period 2017 to 2020. The DTA established over this period is based on the announced Corporation Tax rates, as follows:

Year	Loss Utilised (£m)	CT Rate	DTA (£m)
2017	69.3	19.25%	13.3
2018	25.9	19.00%	4.9
2019	21.6	19.00%	4.0
2020	22.2	17.25%	3.8
Total	139.0		26.0

4. Pensions Benefit Surplus

For solvency purposes, any pensions benefit surplus is valued consistently with IFRS.

Under IFRS, any Pensions Benefit Surplus is valued under IAS19, whereby the net surplus or deficit is calculated annually with the assets valued at fair value and the liabilities discounted at the rate of return available on high quality corporate bonds. The net surplus, to the extent recoverable or deficit is recognised as a pension benefit asset or liability in the Statement of Financial Position. No separate liability for funding requirements is recognised as the Society has an unconditional right to any of the assets of the pension schemes which would remain following the schemes' termination

5. Participations

Under IFRS participations are consolidated within the financial statements. For solvency valuation purposes certain investments are not consolidated and are valued as participations.

Participations	£m
Investments in group undertakings - IFRS	-
Joint venture properties reclassified as participations	119
Adjusted equity method valuation differences	23
Participations per solvency valuation	142

Participations are valued using the Adjusted Equity Method (see Investments below)

6. Investments

For solvency valuation purposes, financial assets are valued consistently with IFRS. However there are also mapping differences between the IFRS and Solvency II hierarchies with certain assets such as Collective Investment Undertakings being presented differently under IFRS and with accrued interest on bonds, deposits and loans included in the market value of the Solvency II valuation.

Under IFRS, financial assets are valued at fair value through income which has two sub categories:

- Financial assets held for trading; and
- Those designated at fair value through income at inception.

Derivatives are classified at fair value through income as they are held for trading. Financial assets designated at fair value through income at inception are measured at market prices, or prices consistent with market ratings should no price be available. Day one gains are recognised only where valuations use data from observable markets. Any unrealised or realised gains or losses are taken to the Statement of Comprehensive Income, as fair value gains or losses, or realised gains or losses respectively, as they occur.

Financial assets at fair value through income; further information is provided in the table below.

Fair value estimation

For Solvency II valuation purposes, the fair value measurement hierarchy is as follows:

- Quoted market prices in active markets for same assets and liabilities (QMP). This is the default valuation method and is broadly consistent with Level 1 category assets under IFRS.
- Quoted market price in active markets for similar assets (QMPS). Maximum use is made of relevant market inputs such as quoted prices for identical or similar assets in an inactive market, observable inputs other than quoted prices and market corroborated inputs derived from observable market data. This is broadly consistent with Level 2 category assets under IFRS.
- Other alternative valuation method (AVM). Unobservable inputs reflecting the assumptions market participants would use when pricing the asset or liability, including assumptions about the risk inherent in both the inputs and the valuation technique. The undertaking uses various valuation approaches, including market, income and cost approaches. This is broadly consistent with Level 3 category assets under IFRS.
- Adjusted Equity Method (AEM) for Participations

The following table presents the financial assets measured at fair value at 31st December 2016.

	QMP £m	QMPS £m	AVM £m	AEM £m	Total £m
Property	-	-	5	-	5
Holdings in related undertakings	-	-	-	142	142
Equities	817	-	55	-	872
Bonds	3,610	3,062	-	-	6,672
Collective Investment Undertakings	3,119	74	-	-	3,193
Derivatives	-	178	1	-	179
Deposits other than cash equivalents	97	-	-	-	97
Investments (other than assets held for index-linked and unit-linked funds)	7,643	3,314	61	142	11,160
Loans and mortgages (see note 9 below)	-	199	685	-	884
Total	7,643	3,513	746	142	12,044

7. Derivatives

For Solvency II valuation purposes, derivatives are valued consistently with IFRS.

Under IFRS, derivatives are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently re-measured at their fair value. Derivatives are valued by discounted cash flow techniques, using observable yield curves and models such as Black Scholes using implied market forward rates and volatilities.

	Asset £m	Liability £m	Total £m
Derivative fair value asset solvency valuation	179	(259)	(80)

8. Assets held for index-linked and unit linked funds

Under IFRS, assets held for index-linked and unit linked funds are included in financial assets at fair value through income (and valued consistently as described in note 6 Investments above).

For solvency valuation purposes, these assets are valued consistently with IFRS but are reported separately.

9. Loans and Mortgages

For solvency valuation purposes, loans and mortgages are valued consistently with IFRS with a reclassification adjustment for accrued interest which is included in investments rather than as accrued interest within other assets.

	£m
Equity release mortgages	685
Commercial mortgages	198
Total included in Financial assets at fair value through income	883
Presentational adjustment for accrued interest	1
Total Loans and Mortgages solvency valuation	884

Equity release mortgages

Equity release mortgages are not actively traded in a secondary market and hence a mark-to-model valuation approach is used which is classified as other Alternative Valuation Method (AVM). (Please see note 6 Investments for full definition of AVM and Section D4). The fair value of the Equity Release mortgage assets is determined using a discounted cash flow model which takes into account the contractual rate of interest charged on the loans, the expected mortality and morbidity of the mortgagor and mortgagor actions.

The discount rate is the zero-coupon swap curve with adjustments for profit and liquidity premiums.

Commercial mortgage valuation

The fair value of the loans secured on commercial property is determined using observable inputs such as discounted cash flows to reflect changes in underlying gilt yields and debt margins. Where the value is not expected to be recovered through ongoing loan payments, the fair value represents the recoverable value of the property in the market post

transaction costs. This basis is classified as level 2 for IFRS and Quoted market price in active markets for similar assets (QMPS) for solvency. (Please see note 6 Investment for full definition of QMPS).

10. Reinsurance recoverables

The undertaking cedes insurance risk in the normal course of business. Reinsurance assets represent balances recoverable from reinsurance companies.

For solvency valuation purposes, reinsurance recoverables are valued using the cash-flow projection method and in a consistent manner with the calculation of the best estimate liabilities. see Section D2. Technical Provisions).

11. Insurance and intermediaries receivables

Under IFRS, insurance and intermediaries receivables are recognised when due and include amounts due from policy holders, agents, brokers and intermediaries. Insurance and intermediaries receivables are initially recognised at fair value and then subsequently held at amortised cost. Where there is objective evidence that the carrying value is impaired then the impairment loss will be recognised in the statement of comprehensive income.

	£m
Total Insurance and intermediaries - IFRS	265
Solvency valuation adjustments	(260)
Total Insurance and intermediaries -solvency valuation	5

For solvency valuation purposes, any future premiums which fall due after the valuation date (included in insurance receivables) and any premium debts (included within intermediaries receivables), are subject to best estimate liability calculation of technical provisions (see D2. Technical Provisions)

12. Cash and cash equivalents

For solvency valuation purposes, cash is valued consistently with IFRS with a reclassification adjustment for short term bank deposits which are included in investments (other than assets held for index-linked and unit-linked funds) as deposits other than cash equivalents.

13. Any other assets, not shown elsewhere

For solvency valuation purposes, prepayments and accrued income are valued consistently with IFRS. On the Solvency II balance sheet, the accrued interest on bonds is included in the market value of Investments.

Under IFRS, prepayments and accrued income balances are all due within one year. These are valued at fair value based on amounts receivable on demand.

	£m
Accrued interest	99
Other prepayments and accrued income	41
Corporation tax asset	6
Prepayments and accrued income - IFRS	146
Presentational adjustments to Investments	(82)
Total any other assets, not elsewhere shown solvency valuation	64

D.2 Technical provisions

D.2.1 Technical provisions by line of business

The following table sets out the Group technical provisions split by Solvency II lines of material business as at 31st December 2016.

Line of Business	31 st December 2016 - £m			
	Best Estimate Liability (BEL)	Risk Margin (RM)	Transitional Measures on Technical Provisions (TMTP) Unaudited	Total Technical Provisions
Motor vehicle liability	1,583	59	-	1,642
Other motor insurance	67	2	-	69
Fire and property damage	163	5	-	168
General liability insurance	65	3	-	68
Other Non-Life insurance	12	1	-	13
Total Non-Life insurance obligations	1,890	70	-	1,960
Insurance with-profits participation	5,575	120	(343)	5,352
Index-linked and unit-linked insurance	2,519	9	(11)	2,517
Other life insurance (including Health)	3,855	147	(556)	3,446
PPOs not health	152	21	-	173
Total Life insurance obligations	12,101	297	(910)	11,488
Total Group Technical Provisions	13,991	367	(910)	13,448

The impact on the MCR and Eligible Own Funds to meet the MCR are found in the section E2.1 of the Group SFCR.

D.2.2 Technical provisions methodology and assumptions

A description of the bases, methods and assumptions used for the valuation of the technical provisions is set out in the following sections (D2.2.1 for Non-life business and D2.2.2 for Life business).

D.2.2.1 Technical Provisions methodology and assumptions for Non-Life business

Motor liability is the most material element of the non-life technical provisions. Of this line of business, by far the most material uncertainty is in relation to bodily injury claims. As bodily injury claims get larger the uncertainty of when and how much any individual claim will settle for increases. Of particular note are Permanent Payment Orders claims whereby a regular payment is awarded to a claimant for a period of time, usually the rest of their life, which is indexed. Thus claims that settle as a PPO introduce inflation and mortality risk, both of which are historically unusual concepts for a short-tail general insurance business.

The technical provisions for the Non-Life business are calculated using a range of standard actuarial and statistical techniques. This includes, where appropriate, stochastic models.

For attritional claims, these methods rely primarily on the 'chain-ladder' methods which use historic claim development triangles to attempt to predict the future development of claims which are reported but not settled and claims that are yet to be reported. For more recent periods, trended methods are adopted.

For non-PPO large claims a separate stochastic method is adopted that assumes claims settle with a severity that is consistent with a standard statistical distribution. For large claims that are yet to be reported a similar stochastic model is used but which additionally allows for an assumed distribution of the frequency of claims to be reported that differs by reporting delay.

For PPO claims a cashflow model is used. The primary assumptions made relate to future wage inflation for care workers, investment returns (by which cashflows are discounted), base mortality of claimants and any expected reduction in life expectancy due to the severity of the injuries suffered by the claimant.

The premium provision is the discounted cashflow in respect of premium receivables, claims and expenses arising from incepted unearned and un-incepted business. The undiscounted cash-flows are calculated using a suite of assumptions and are grouped into the Solvency II Lines of Business. The unearned premium and un-incepted premium runs-off over the subsequent twelve months and is adjusted to allow for several factors affecting claims and expenses. The claims and expenses generated from the unexpired risk are calculated and a cashflow produced, in line with the methodology

employed in the calculation of the Claim Provision and allows for both reinsurance and the reinsurer default risk. Discounting these cashflows by the Solvency II lines of business produces the Solvency II Premium Provision.

Under Solvency II, insurers are required to allow for all possible events when setting their technical provisions, including those 'that may not have been realised historically (EIOPA/CEIOPS and Lloyd's guidance). These are termed Events Not in Data (ENID) or Binary Events.

The ENIDs loading has been reviewed for the 2016 Year End and a new approach has been used.

Overall the ENIDs loading for LVGIG is 2.9%. This is split between claims provision loading of 2.5% and a premium provision loading of 3.7% based on the relative claims exposures as at Year End.

The approach used to derive the ENIDs loading has considered a combination of the scenarios for the large claims and catastrophic weather events, and a mean load statistical approach for the Attritional claims. The ENID loadings derived are split by the main products. Future cashflows used for the calculation of the Solvency II technical provisions are derived from payment patterns consistent with the IFRS Actuarial Best Estimate (ABE). All cashflows under Solvency II are discounted using the risk-free rate as prescribed by EIOPA.

The Risk Margin is calculated in line with the Solvency II regulations. Further details are provided in the entity sections later in this document.

All methods are supplemented by regular interaction with Claims and Underwriting functions to better understand the trends in the reserving projections and the assumptions inputted into the Premium Provisions.

D.2.2.2 Technical Provisions methodology and assumptions for Life business

Technical provisions have been calculated as the sum of the BEL and Risk Margin.

BEL

The BEL is calculated in accordance with the Solvency II Directive, Delegated Regulations and regulator guidance. The following sections describe how the rules and guidance have been applied to the Society. Unless otherwise stated the methodology and assumptions apply to all types of business.

The BEL is the probability weighted average of future cashflows required to fulfil obligations to policyholders under existing contracts taking account of the time value of money using the relevant risk-free interest rate term structure and allowing for contract boundaries. The Society allows for an adjustment due to contract boundaries, however, the adjustment is not material. The cashflows are projected gross, without deduction of the amounts recoverable from reinsurance contracts. Recoverables from reinsurance contracts are calculated separately and are included as an asset on the balance sheet.

Risk Margin

The Risk Margin represents the estimated cost of the capital a third-party insurer would be required to hold to support the Society's insurance business over its period of run-off. It is derived by projecting the SCR forward (for the Society under the Standard Formula, and removing MA and VA) using a cost of capital of 6%. The third-party insurer is assumed to hedge any market risks, where possible. The Society believes that all its market risk exposures could be hedged, so the calculation allows only for non-market risks. The Society projects the SCR for most risks using a proxy (an item, such as the BEL, which is expected to move broadly in line with the size of the stress). However for material product and risk combinations, the SCR projection approach is used. The individual risk SCR's are then summed over all the products to produce the SCR for each risk. The total is reduced where appropriate to allow for the mutual bonus management action (the removal of past mutual bonus additions from with-profit policies in each of the three largest individual risks) and the aggregate SCR is determined by applying a correlation matrix. The correlation matrix assumed is the same as that used for the Life and Health Standard Formula SCR. These SCRs are then discounted and the prescribed cost of capital rate of 6% per annum is applied.

Risk-Free Rates

The basic risk free interest rate term structure of spot rates as published by EIOPA was used. No transitional adjustment was made to the discount rate.

Matching Adjustment

The Matching Adjustment (MA) has been applied (having been approved for use by the PRA) for all annuity business in the Matching Adjustment Portfolio. The MA is an addition that can be made to the risk-free yield curve to allow for the higher expected returns on the assets supporting the liabilities. This is available for annuity business where the cashflows are reasonably predictable, and therefore a portfolio of government and corporate bonds can be purchased with cashflows that match those of the liabilities sufficiently closely. The addition to the risk free curve is calculated as the addition to the discount rate needed to set the value of liabilities equal to the value of assets. Within this calculation a deduction is made for potential defaults and the cost of downgrade on the bond portfolio (the 'fundamental spread'):

The assets used to back the annuities within the Matching Adjustment Portfolio are:

- Government bonds (including inflation-linked government bonds);
- Corporate bonds;
- Commercial Mortgage Loans;
- Interest rate swaps;
- Cashflow swaps ; and
- Cash
-

The MA used at the valuation date was 112bps.

Volatility Adjustment

The Volatility Adjustment (VA) has been applied (having been approved for use by the PRA) for all Life policies outside the Matching Adjustment Portfolio, except for Protection and Unit Linked Pensions policies and the business acquired from Teachers Provident Society).

The VA prescribed by EIOPA was 30bps at the valuation date.

Transitional Measure on Technical Provisions (TMTP) – unaudited

The TMTP provides firms with relief from day 1 from the financial impact on technical provisions of moving to the Solvency II regime. The relief then amortises annually over 16 years. The TMTP was used for Life and Health business (except within the TA Fund). The TMTP is recalculated every 24 months or sooner if there is a change in risk profile that materially impacts the TMTP. The TMTP was last recalculated as at 31st August 2016, with this value used as at 31st December 2016. The TMTP is restricted where necessary so that the Financial Resources Requirement (the sum of the technical provisions, other liabilities and the SCR) is no lower under Solvency II than would have been the case under the previous solvency regime, although this restriction did not apply at the last recalculation point.

As the TMTP runs off over 16 years, the first annual step down occurred on 1st January 2017, reducing Group surplus capital by £52 million.

Impact of the Matching Adjustment, Volatility Adjustment and Transitional Measure on Technical Provisions
The impact of not applying the MA, VA or TMTP is set out in S.22.01.22, an extract of which is below:.

£m	Amount with Long Term Guarantee measures and transitionals	Impact of transitional on technical provisions - unaudited	Impact of volatility adjustment set to zero	Impact of matching adjustment set to zero
Technical provisions	13,448	910	157	253
Basic own funds	1,411	(868)	(157)	(253)
Eligible own funds to meet Solvency Capital Requirement	1,411	(868)	(157)	(253)
Solvency Capital Requirement	1,044	1	19	31

Tax

All products are classified as either Basic Life Assurance and General Annuity Business (BLAGAB) or non-BLAGAB business. As a mutual, the Society is exempt from tax on non-BLAGAB business, and therefore no allowance for taxation is made in the calculation of the BEL. For products classified as BLAGAB, allowance is made for “I-E” taxation, where “I-E” refers to the liability to tax on any excess of investment income over expenses

With-Profits specific

The costs of guarantees, options and smoothing form part of the BEL. These are calculated using stochastic methods. A market-consistent set of economic scenarios is generated and the costs valued in each scenario using a discount curve equal to the projected future risk-free curve for that scenario. These scenarios are produced by an Economic Scenario Generator (ESG).

Actual historical investment data was used to derive retrospective asset shares. The assumed future investment returns for each asset class for with-profits business were derived using the market-consistent ESG.

A simplifying assumption of combining similar asset classes was used, such as modelling all equities (whether UK or Overseas) as UK Equities and treating all fixed interest bonds as zero coupon UK government bonds.

When projecting future investment returns, the various benchmark asset mixes are used throughout the projection. The Equity Backing Ratio is allowed to change in line with the future management action modelled for LVFS with-profits business in the main with-profits fund only.

Regular Bonus (RB) rates are generally assumed to continue at the same level as at the valuation date.

Profits from business risks are being allocated through the declaration of Mutual Bonus which is allowed for in the BEL.

Final Bonus rates are set equal to the current declared Final Bonus rates for the first time step. Thereafter, an algorithm is used to calculate future Final Bonus rates given the modelled economic scenario and the bonus philosophy set out in the PPFM.

Mortality and Morbidity

Life Protection and Annuity business is exposed to changes in life expectancy (mortality – reduced life expectancy, longevity – increased life expectancy) and health expectancy (morbidity) experience.

Protection business is exposed to mortality and morbidity risks as higher mortality rates and adverse morbidity will lead to increased claims, which in turn, lead to an increase in contract liabilities. Conversely, annuity business is exposed to an increase in life expectancy.

The assumed rates of mortality and morbidity are set in line with recent experience, where it is available in sufficient volume to provide reliable results. Where the experience is not considered sufficient, the assumptions are set by reference to either industry experience or the terms on which the business is reinsured.

The mortality assumed for the different modelled products for year-end 2016 is shown in the tables below.

LVFS

Product	Base Percentage	Mortality Tables
Enhanced Annuities	95%	RMV00/RFV00 CMI_2013 1.5% LT with enhancements
Standard Annuities	95%	RMV00/RFV00 CMI_2013 1.5% LT
Deferred Annuities (Pre-vesting)	130%	AMC00/AFV00 CMI_2013 1.5% LT
Deferred Annuities (Post-vesting)	110%	RMV00/RFV00 CMI_2013 1.5% LT
Term Assurances (FPP) ¹	85.95%	TMN00/TMS00/TFN00/TFS00 adjusted CMI_2013 1.5% LT
Term Assurances (LVLI) ⁶	100%	TMN00/TMS00 TFN00/TFS00 adjusted
Term Assurances (LVFS)	Various	AM80/AF80
IB Endowment/Whole of Life Assurance ²	80%	ELT16
Whole of Life Assurances (50+) ⁶	100%	AMC00/AFV00 adjusted CMI_2013 1.5% LT
Whole of Life Assurances (Lifetime+) ³	100%	TMN00/TFN00/TMS00/TFS00 adjusted CMI_2013 1.5% LT

RNPFN Fund

Product	Base	Mortality Tables
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¹ A series of duration and age-related adjustment factors were applied to the base mortality rates for Protection Term Assurances and 50+ Whole of Life Assurance. These adjustments vary by product line and smoking status

² A series of age-related adjustment factors were applied to the base mortality tables for IB products.

³ A series of age, duration and sum assured-related adjustment factors were applied to the base mortality rates for Lifetime+ Whole of Life Assurance.

	Percentage	
Annuities in Payment	See right	72% IML00/85% IFL00 CMI_2009 1.75% (male)/1.5% (female) LT
Deferred Annuities	50%	AM00/AF00
Other Life Assurance	60%	AM00/AF00

The mortality rates used for the enhanced annuities were adjusted for the additional mortality expected to apply to the lives concerned, with an allowance for the mortality to converge to standard mortality at advanced ages. For this purpose, the business was divided into groups by broad types of medical condition or lifestyle.

Mortality Improvements

For LVFS protection policies and annuities, an allowance was made for future mortality improvements, using the Institute and Faculty of Actuaries Continuous Mortality Investigation (CMI) 2013 projection model (with standard settings), together with a long term improvement rate of 1.5% for both males and females, tapering linearly to zero between the ages of 90 and 120.

For annuities in the RNPFFN Fund, the CMI 2009 projection model was used (with standard settings), together with a long term improvement rate of 1.75% for males and 1.5% for females, tapering linearly to zero between the ages of 90 and 120. The basis differs to that for LVFS due to low materiality.

Persistency

Persistency relates to how long a policyholder retains the product and influences the Society's ability to recover initial costs of sale from premiums and charges that relate to the product. Persistency assumptions include allowances for lapse, becoming paid-up, surrenders, withdrawals and transfers. Additionally, cash commutation and guaranteed annuity rate (GAR) take up rates are covered; as is an allowance for 'gone-aways' under IB whole-of-life with-profits business. These assumptions, which will typically vary by product line, duration in-force, fund size and sales channel, are largely based on internal experience investigations and expert judgement.

For unit linked pensions, a single persistency rate is used to cover external transfers, internal transfers, death, early retirements and drawdown (both regular and additional)

Cash commutation rates are segmented by relevant homogeneous groups. These are set using expert judgement and recent experience.

"Gone-aways" arise where policyholders are no longer aware of the existence of their policy and it is not practical to trace them, and so they are unlikely to give rise to a claim. The level of gone-aways is set by comparing the mortality experience under non premium paying policies (where "gone-aways" arise) with that under premium paying policies (where there should be no "gone-aways") and applying expert judgement.

Expenses

All expense cashflows incurred in servicing the liabilities relating to existing contracts over their future lifetime were taken into account in determining the best estimate liabilities. The modelled expense cashflows assume a maintenance unit cost that is derived from an internal expense analysis..

The following expenses were included in the internal expense analysis:

- Administrative expenses
- Claims management expenses
- Acquisition expenses.

This expense analysis allocates costs at cost centre level to acquisition and maintenance, and across product groups. The maintenance unit cost is then derived at a product level from the amount of allocated cost and the I policy count.

The current year unit costs have been adjusted to remove costs that are not considered to be long term in nature. An additional expense reserve has been set up to allow for these costs. The additional expense reserve (which is not material) has not been allocated at policy level, and is held as a liability outside of the Technical Provisions.

In addition to maintenance services costs, investment expenses associated with products are allowed for in the Best Estimate Liabilities. For some products, investment expenses are modelled explicitly; for others, they are modelled through an adjustment to the discount rate.

Inflation

The assumed inflation measure was the Retail Price Index (RPI). For with-profits business, inflation is linked to the ESG. RPI-linked liabilities were projected to increase in line with RPI, consistent with contractual terms. Expense inflation was based on RPI plus a margin.

Events not in data (ENIDs)

ENIDs refer to any events that are not captured within the data used derive the assumptions underlying the Best Estimate Liabilities. For life business, material ENIDs are allowed for by adjusting the best estimate assumptions using expert judgement and any relevant available data.

Simplifications

The use of simplifications within the Group is not considered material.

D.2.2.3 Uncertainty within the Technical Provisions

The calculation of the Technical Provisions uses established actuarial and statistical techniques to produce a best estimate of expected realistic future cash flows and liabilities. These calculations are nevertheless based on data, assumptions and models, which may not reflect actual future experience. As such a level of uncertainty is associated with these results. Other notable areas of uncertainty include

- The quality of the data, especially around older policies on legacy administration systems
- The assumptions used by the models; in particular in terms of investment experience or policyholder behaviour. These assumptions are discussed above. The sensitivity of the results to these assumptions can best be seen by considering the makeup of the SCR, and the underlying sensitivities. Details of this can be found in sections C and E.
- The assumptions used in the coding of the models, including the output economics generated by the Economic Scenario Generator (ESG). This may include simulation methods, deterministic techniques and analytical techniques. For certain life insurance liabilities, in particular for future discretionary benefits, simulation may lead to a more appropriate and robust valuation of the BEL. The Group uses stochastic techniques to value both the with-profits benefits and the value of guaranteed annuity options.
- For Non-Life, uncertainty in respect of policyholder behaviour is allowed for within the calculation for bound but not incepted business.
- As of March 2017, the Ogden discount rate has been changed from +2.5% p.a. to -0.75% p.a. In the interim whilst the underlying claim systems were not immediately updated, an estimated impact was applied to the IFRS ABE as at the 2016 year-end allowing for the impact of the incurred, PPO propensity, incurred but not yet reported (IBNYR) and reinsurance. The method allowed for all the large claims, the claims mostly impacted by the change in Ogden Rate, to be recalculated on an individual claim by claim basis on the new rate and revised estimated reinsurance recoveries. The expected IBNR claims and assumed PPO propensity were also adjusted to reflect the new Ogden rate. Smaller claims which are not so materially impacted by the rate change were uplifted by an expected average increase for these type of claims. As such, this overlay does also add to the uncertainty around the technical provisions.

D2.3 Comparison of Solvency II and IFRS technical provisions

The table below shows the difference between the gross technical provisions under both Solvency II and IFRS.

Technical Provisions (gross)	Solvency II value £m	IFRS value £m	Difference £m
Total Non-Life insurance obligations	1,960	1,917	43
Insurance with-profits participation	5,352	5,689	(338)
Index-linked and unit-linked insurance	2,517	2,521	(3)
Other life insurance (including Health)	3,446	4,498	(1,052)
PPOs not health	173	85	88
Total Life insurance obligations	11,488	12,793	(1,305)
Total Group Technical Provisions	13,448	14,710	(1,262)

The Risk Margin and TMTP are significant sources of difference between Solvency II and IFRS; there is no equivalent in the latter. The Risk Margin and TMTP are discussed earlier in Section D.

The other principal differences between Solvency II and IFRS are as below.

Life business

Discount rates: Whilst the risk-free reference curve under IFRS is the gilt curve, the risk-free curve under Solvency II is prescribed by EIOPA and is derived from swap rates. Additionally, the Society makes use of the VA and MA under Solvency II, which allow the liabilities for some products to be discounted at rates higher than risk-free. There is no equivalent to the VA under IFRS but the illiquidity premium, which represents compensation for risks not borne by a portfolio of 'hold to maturity' assets (as is the case with annuity business), that is used for IFRS is broadly similar to the MA. Under IFRS, the illiquidity premium is applied to all non-profit annuity business but under Solvency II, the MA is applied to annuity business within the Matching Adjustment Portfolio and the VA applied to all other annuity business (including with-profits annuities).

For the with-profits business, the movement in the EIOPA-curve with the VA is the primary difference between Solvency II and IFRS (other than the Risk Margins and TMTP).

Prudent margins: These exist under IFRS to allow for uncertainty. Under Solvency II, uncertainty is allowed for within the SCR. Margins are generally allowed for within non-profit business rather than the with-profits business. For Protection business (which sits within 'Other life insurance (including Health)'), the impact of removing the margins is a particularly material difference between IFRS and Solvency II.

Present value of future profits: Under IFRS, the technical provisions for non-profits business are calculated with margins for adverse deviation, and separately, the value of the release of these margins is calculated (PVFP). This separation is not present in the direct BEL calculation under Solvency II, which contains a best-estimate projection of future cash flows.

Surplus in closed funds: There is a presentational difference for the surplus in closed funds; under IFRS this is a liability whereas under Solvency II it is an adjustment to Own Funds.

Contract boundaries exist under Solvency II but not IFRS; however, they are not a material source of difference for the Society.

Non- Life business including PPOs

For Non-Life business, the Solvency II BEL is directly linked to the IFRS ABE. However, there are elements of the ABE which are required under IFRS that are not required under Solvency II and vice versa. Broadly, these can be summarised as follows:

- An explicit claims margin is inadmissible under Solvency II. However this is replaced by an allowance for Events Not In Data (ENIDs) which is calculated using standard actuarial techniques;
- Under IFRS where liabilities are discounted (only PPOs) the Group can make an appropriate assumption as to expected asset returns whereas under Solvency II all liabilities (PPOs and non-PPOs) must be discounted using the yield curve specific to the UK as set by EIOPA; and
- The UPR under IFRS is inadmissible under Solvency II. However, this is replaced by the premium provision.

D.2.3.1 Description of Reinsurance Recoverables

Life business

The BEL was calculated gross without deduction of amounts recoverable from reinsurance contracts. The calculation of recoverable amounts was carried out separately for reinsurance contracts as the probability-weighted average of the discounted future cashflows allowing for contract boundaries. The assumptions and models used were the same as those used for the BEL, described earlier in this section.

The reinsurance recoverables were reported as a reinsurance asset on the balance sheet and include a deduction for the risk of reinsurer default.

Generally, there is no allowance for any future reinsurance purchases that may be used to cover existing obligations or for future business in the BEL that was expected to be written under the treaties. The exception is the future incepting RNPFN annuities which are expected to be covered by increased reinsurance.

The Matching Adjustment was calculated using liability cash-flows gross of reinsurance, with the methodology allowing for longevity swap recoverables in the asset cashflows.

Non-Life business

The Non-Life business enters into a number of reinsurance contracts. Most materially this includes an excess of loss arrangement to cover liability-related exposure with a retention set in line with the Group risk appetite. At the 2015 year-end the Group also entered into a General Insurance portfolio-wide Loss Portfolio Transfer arrangement for accident years 2015 and prior inclusive. Simultaneously, the Group entered into a quota share arrangement for the 2016 accident year which has been renewed on the same terms for the 2017 accident year. Similarly to Life business, the reinsurance recoverables were reported as a reinsurance asset on the balance sheet and include a deduction for the risk of reinsurer default.

There were no Special Purpose Vehicles (SPVs) in the Group.

D.2.3.2 Material Changes in Assumptions

The basis used to calculate cash payments under OB Pensions policies was reviewed during 2016. The calculation of the BEL at the year-end reflects the new basis approved by the Board

The mortality and persistency assumptions for Lifetime+, a whole-of-life protection product, were changed to align more closely to experience.

The PRA approval of the matching during 2016 adjustment resulted in a significant reduction in the Technical Provisions (before TMTP), along with a reduction in the level of TMTP.

The calculation of the insurance contract liabilities is impacted by changes in unit costs. A review of the methodology was performed in 2016 and the revised expense assumptions from this review have been adopted. A number of other demographic assumptions were amended to reflect the emerging experience.

For Non-Life business, many of the elements of assumptions are updated throughout the year in line with changes in the IFRS ABE. In particular:

- Cashflow patterns;
- Expenses; and
- Allowance for reinsurer counterparty default;

Premium provision assumptions are updated in line with the reforecasting of the business Plan throughout the year.

The methodology for calculation of the ENID has been significantly enhanced throughout the year.

In February 2017, the Ogden discount rate has been changed from +2.5% p.a. to -0.75% p.a. In the interim whilst the underlying claim systems were updated, an estimated impact was applied to the IFRS ABE as at the 2016 year-end allowing for the impact of the incurred, PPO propensity, incurred but not yet reported (IBNYR) and reinsurance. As such, this overlay does also add to the uncertainty around the technical provisions.

As the source claim systems are updated in April 2017 the estimate will be unwound and replaced with a final calculation which, in the absence of further changes to the rate through 2017, will be reflected in the 2017 year-end position.

D.3 Other liabilities

	Note	2016			
		IFRS	Presentation adjustment	Solvency valuation adjustment	Solvency
		£m	£m	£m	£m
Provisions other than technical provisions	#	12	(1)	-	11
Pension benefit obligation	#	-	1	-	1
Deferred tax liabilities	1	70	-	3	73
Derivatives	#	259	-	-	259
Debts owed to credit institutions	2	116	-	-	116
Financial liabilities other than debt owed to credit institutions	#	1	-	-	1
Insurance and intermediaries payables	3	19	-	46	65
Reinsurance payables	4	31	-	(29)	2
Payables (trade, not insurance)	5	269	(14)	(22)	233
Subordinated liabilities	6	357	-	28	385
Any other liabilities, not elsewhere shown	7	28	(17)	-	11
Total Other Liabilities		1,162	(31)	26	1,157

#= Disclosure note not provided as solvency value equal to IFRS or the amounts are immaterial.

Supporting Notes

1. Deferred tax liability

IFRS Deferred Tax Liabilities at 31st December 2016 are £70m and relate to timing differences recognised on unrealised gains and the pension scheme. Solvency II Deferred Tax Liabilities are £73m. The movement from the IFRS DTL reflects the Highway losses shown as a DTA in Solvency II of £4m (see deferred tax asset) less the removal of the LVIC IFRS DTL Goodwill under Solvency II (£1m).

2. Debts owed to credit institutions

For solvency valuation purposes, debts owed to credit institutions are valued consistently with IFRS.

LVFS uses financial instruments to transfer elements of financial market risk exposures. Significant counterparty exposures are mitigated by the use of collateral. For over-the-counter transactions undertaken by the Society, collateral is received from the counterparty. The collateral can be sold or re-pledged by the Society and is repayable if the contract terminates or the contract's fair value decreases.

The maturity profile of the liability recognised in the financial statements is summarised in the following table.

						£m
	Within 1 year	1 - 3 years	3 - 5 years	Over 5 years	UL	Total
Debts owed to credit institutions	-	-	-	116	-	116

3. Insurance and intermediaries payables

For Solvency II valuation purposes, debts owed to credit institutions are valued consistently with IFRS however are reclassified from technical provisions.

Under IFRS, insurance payables are recognised when due and include amounts due to policyholders, agents, brokers and intermediaries. Where there is objective evidence that the carrying value is impaired then the impairment loss will be recognised in the statement of comprehensive income. Insurance payables are initially recognised at fair value and subsequently held at amortised cost.

Insurance and intermediaries payables	£m
Due to policy holders	18
Due to intermediaries	1
Total insurance and intermediaries payables - IFRS	19
Reclassification from technical provisions to insurance and intermediaries payables	46
Total insurance and intermediaries - solvency valuation	65

The maturity profile of the liability recognised in the financial statements is summarised in the following table:

						£m
	Within 1 year	1 - 3 years	3 - 5 years	Over 5 years	UL	Total
Insurance and intermediaries payables	19	-	-	-	-	19

4. Reinsurance payables

For solvency valuation purposes, are valued consistently with IFRS but are reclassified to technical provisions.

Under IFRS, reinsurance payables are recognised when due. Where there is objective evidence that the carrying value is impaired then the impairment loss will be recognised in the statement of comprehensive income. Reinsurance payables are initially recognised at fair value and subsequently held at amortised cost.

Reinsurance payables	£k
Due to reinsurers	31
Total reinsurance payables - IFRS	31
Reinsurance payables included in BEL calculations	(29)
Total reinsurance payables solvency valuation	2

5. Payables (trade, not insurance)

For Solvency II valuation purposes, debts owed to credit institutions are valued consistently with IFRS.

Under IFRS, reinsurance payables are recognised when due. Where there is objective evidence that the carrying value is impaired then the impairment loss will be recognised in the statement of comprehensive income. Reinsurance payables are initially recognised at fair value and subsequently held at amortised cost.

Payables (trade, not insurance)	£m
Bank overdrafts	22
Trade payables	27
Other taxes and social security costs	51
Other creditors	36
Finance lease liabilities	20
Accruals and deferred income	113
Payables (trade, not insurance) - IFRS	269
Presentational adjustments (including accrued income to Investments)	(12)
Solvency valuation adjustments- Reclassification of payables included in BEL calculations	(22)
Payables (trade, not insurance) – solvency valuation	233

The maturity profile of the liability recognised in the financial statements is summarised in the following table:

						£m
	Within 1 year	1 - 3 years	3 - 5 years	Over 5 years	UL	Total
Payables (trade, not insurance)	200	2	2	23	-	227

The financial liability is presented based on the undiscounted contractual obligations and as such will not agree with the balances disclosed within the Statement of Financial Position in the statutory financial statements.

6. Subordinated liabilities

In 2013 the Society issued £350m of Fixed Rate Reset Subordinated Notes at par. The effective interest rate on the Notes is 6.654%. The Notes have a maturity date of 22 May 2043 but the Society has the option to redeem the Notes at the first call date of 22 May 2023 and at five yearly intervals thereafter up to the maturity date.

Interest is payable on the Notes at a fixed rate of 6.5% per annum for the period until the first call date on 22 May 2023, payable annually in arrears on 22 May each year. If the Notes are not redeemed on 22 May 2023, the interest rate is reset on that date and at five yearly intervals thereafter at a rate equal to the five year gilt rate quoted on the day before the reset date plus an initial margin of 463 basis points and a step up margin of 100 basis points. There is an option of cumulative deferral of interest at the issuer's discretion and mandatory interest deferral in the event that a regulatory deficiency interest deferral event has occurred or is continuing (breach of the applicable regulatory solvency capital requirement of the issuer or group) or would occur if payment of interest on the subordinated notes were to be made. Following any deferral of a principal or interest payment, the Society would be prevented from declaring any distribution to members which falls within the Mutual Bonus arrangements.

The Society has the option to elect to defer payment of interest in whole or in part and this will not constitute a default or give the right to the noteholders or the trustee to accelerate repayment of the Notes or to take any enforcement action. This Subordinated Note meets in full the requirements in Article 73 of the Delegated Acts and as such are classed as Tier 2 Capital.

In addition, Highway has a €12m non-callable Subordinated Note in issue repayable in 2034. Interest is payable on the Note at the 3 month euro deposit rate plus a margin of 365 basis points. Under transitional rules, this subordinated note has permission to be classified as Tier 2 Basic Own Funds.

For solvency valuation purposes, the Notes are measured using the risk free rate at the valuation date, whilst keeping the spread versus risk free rate at point of issue constant, thus eliminating the effect of changes in credit rating. The model uses the discounted cashflow approach with the spread measured against the risk free rate to equate back to the amount of debt issued. It also allows for accrued interest at point of valuation.

Under IFRS, the Notes are initially measured at the fair value of the proceeds less attributable transaction costs. Subsequent to initial recognition they are measured at amortised cost. The transaction costs are amortised over the period to the earliest possible redemption date on an effective interest rate basis. The amortisation charge is included in the Statement of Comprehensive Income within finance costs. An equivalent amount is added to the carrying value of the liability such that at the redemption date the value of the liability equals the redemption value.

Subordinated liabilities	£m
Subordinated notes (GBP 350m)	347
Subordinated notes (EUR 12m)	10
Subordinated liabilities -IFRS	357
Solvency II valuation adjustments	28
Subordinated liabilities solvency valuation	385

The subordinated liability is expected to be settled more than 12 months after the balance sheet date.

More information on the terms and conditions are available if needed.

7. Any other liabilities, not shown elsewhere.

Under IFRS, Open-Ended Investment Companies (OEICs), are fully consolidated into the financial statements where the group is the dominant investor and therefore management have concluded that the Group has control of the OEIC.

For solvency valuation purposes, OEIC's are valued consistently with IFRS, however they are not fully consolidated but held as an investment

	£m
Net asset value attributable to external unit holders	28
Net asset value attributable to external unit holders - IFRS	28
Presentational adjustments	(17)
Total any other assets, not elsewhere shown - solvency valuation	11

8. Contingent liabilities

There are no material contingent liabilities to be recognised for solvency valuation purposes.

D.4 Alternative methods for valuation

Information is provided for assets valued using alternative methods.

Justification for using alternative methods

The Group aims to use quoted market prices or observable inputs to value all assets and liabilities however where there is no external market or readily observable inputs, the Group will use an alternative method such as discounted cash-flow or mark-to-model.

Assumptions used in valuation approach and areas of uncertainty

Alternative methods for valuation include the use of estimates and assumptions that are not market observable but are based on a combination of internally developed models, calibrated to market observable data where possible as well as independent third-party evidence. Valuation uncertainty arises where there is reliance on third-party adherence to expected valuation standards or potential variation in the expected range of the key inputs into models.

Life Segment

The following material assets have been valued using alternative valuation methods in accordance with Article 263 of the Delegated Acts:

- Equity release mortgages are the only financial instrument the Group has which is significantly impacted by reasonably possible changes in unobservable inputs. The loans secured on residential property are sensitive to changes in discount rate spread, which includes the profit and liquidity premium. The impact of reasonably possible alternative assumptions is shown in table below;

Description	Unobservable input	2016		
		Reasonably possible alternative assumptions		
		Current fair value	Increase in fair value	Decrease in fair value
		£m	£m	£m
Loans secured on residential property	Discount rates	685	38	-35

For Equity release mortgages (£685m), please refer to Section D Assets Note 6 Loans and Mortgages, sub-heading Equity release mortgages for the valuation basis.

- Unlisted equity (£174m) being private equity holdings are valued at net asset value using unobservable external prices factoring in distributions or calls since the latest valuations. The private equity valuations are reviewed on a monthly basis by LVFS Group Treasury to ensure ongoing validity and accuracy.
- Property (£5m) is valued in accordance with the RICS Appraisal and Valuation Standards by professional, third party, independent chartered surveyors Eddisons Commercial Ltd. The valuation is on an income approach basis and requires the use of observable inputs for rental income and yield assumptions which take into account comparable properties.
- Property, plant and equipment (£43m) is valued at fair value which that the IFRS carrying value, based on amortised cost, to be materially the same as fair value.

Non-life Segment

The following material assets have been valued using alternative valuation methods in accordance with Article 263 of the Delegated Acts:

- Deferred tax assets have been valued in line with IFRS, adjusted for the tax impact of temporary differences including goodwill, intangible assets and reserves as valued under Solvency II regulations. The value of the deferred tax asset arising was validated based on Board approved plan future taxable profit projections. The profits used will not include any reversal of the risk margin.
- Reinsurance recoverables from Non-Life excluding Health have been valued using the cash flow projection method, in a consistent manner with the calculation of the best estimate liabilities and adjusted for expected losses due to the default of reinsurance counterparties. Further information regarding the best estimate liabilities can be found earlier in Section D.

- 3) Receivables (trade, not insurance) and any other assets (not elsewhere shown) are valued consistently with IFRS. Management believe this to be representative of the fair value at the reporting date.

The following material liabilities have been valued using alternative valuation methods in accordance with Article 263 of the Delegated Acts:

- 1) Best Estimate Liability and Risk Margin have been valued under solvency methodologies and further information can be found in Section D2 of this report.
 2) Derivatives have been valued consistently with IFRS using mark to model valuation as detailed below :

Description	Valuation technique	Unobservable inputs	Range of unobservable inputs (probability weighted average)	Relationship of unobservable inputs to fair value
Derivative liability	Mark-to-model	Gilt repo rates	The range on market gilt repo rates offered can be up to 10 bps	A gilt repo rate increase will result in a lower contract value

- 3) Payables (trade, not insurance) are initially valued consistently with IFRS. The Motor Insurance Bureau (MIB) levy is then removed from the payable balance and included within the Best Estimate Liability calculations. Further information on this calculation can be found in Section D2 of this report.

D.5 Any other information

The Group does not consider that there is any further information which is required to be reported in respect of the solvency valuation approach.

E. Capital Management (LV Group)

The Capital Management section of the report describes the objectives and approach that the Group takes in managing its capital position. The section provides information about the structure and quality of own funds and the calculation of the SCR under the Standard Formula.

E.1 Own funds

The Group seeks to create value for its members by investing in the development of the business while maintaining an appropriate level of capital available. The risk appetite for each type of principal risk is set based on the amount necessary to meet the solvency capital requirements.

a) Policies and objectives

The Group's key capital management objectives are:

- i) To ensure the Group's strategy can be implemented and is sustainable;
- ii) To ensure the Group's financial strength and to support the risks it takes on as part of its business;
- iii) To give confidence to policyholders and other stakeholders who have relationships with the Group; and
- iv) To comply with Solvency II capital requirements imposed by its UK regulator, the PRA.

These objectives are reviewed at least annually, and benchmarks are set by which to judge the adequacy of the Group's capital. The capital position is monitored against those benchmarks to ensure that sufficient capital is available to the Group. The Group is required to hold sufficient capital to meet the Solvency II capital requirements based on the higher of the Solvency Capital Requirement or Minimum Capital Requirement.

The assessment depends on various actuarial and other assumptions about potential changes in market prices, future operating experience and the actions management would take in the event of particular adverse changes in market conditions.

Management intends to maintain surplus capital in excess of the SCR and MCR to meet the PRA's total requirements and to maintain an appropriate additional margin over this to absorb changes in both capital and capital requirements. This is the responsibility of the Group Finance Director and is monitored through the Group ALCO committee, one of the day to day monitoring committees which feeds into the Board (shown in the chart in Section B Systems of Governance, "Implementing Risk Management across the Group")

b) Measurement and monitoring of capital

Method 1 as referred to in Articles 230 of Solvency II directive is applied by the organisation to calculate the group solvency position.

The capital position of the Group is monitored on a regular basis and reviewed formally on a quarterly basis by the Group ALCO. These objectives are reviewed and benchmarks are set by which to judge the adequacy of the Group's capital and ensure that sufficient capital is available.

The Group's capital requirements are forecast on a regular basis and compared against the available capital and the Group's minimum internal rate of return. The internal rate of return forecast to be achieved on potential investments is also measured against minimum required benchmarks taking into account the risks associated with the investment.

In the event that sufficient capital is not available, actions would be taken either to raise additional capital or to reduce the amount of risk accepted thereby reducing the capital requirement through, for example, reinsurance, reducing business volumes or a change in investment strategy.

The items reported under Own Funds are classified by the regulations and split into three categories depending on different factors such as quality, liquidity and timeline to availability when liabilities arise. Tier 1 includes ordinary share capital, non-cumulative preference shares and relevant sub-ordinated liabilities. Tier 2 includes cumulative preference shares, and sub-ordinated liabilities with a shorter duration. Tier 3 own funds are those which do not satisfy the tier 1 or tier 2 requirements.

Different limit amounts held under the three tiers apply to the MCR and SCR. As tier 1 comprises the highest quality with the longest redemption period, the majority of the eligible amount of own funds to cover the MCR and SCR is composed of Tier 1 own funds.

c) Own fund items

The following table details the structure, amount and quality of basic own funds and ancillary own funds (excluding the surplus from ring fenced funds which are not available to the Group).

	Tier 1 £m	Tier 2 £m	Tier 3 £m	Total £m
Surplus funds	1,117	-	-	1,117
Reconciliation reserve	(115)	-	-	(115)
Subordinated liabilities	-	385	-	385
Deferred tax assets	-	-	26	26
Minority interests	(2)	-	-	(2)
Total Basic Own Funds	1,000	385	26	1,411
Total Basic Own Funds after deductions	1,000	385	26	1,411

Surplus Funds

Surplus funds are similar to the unallocated divisible surplus of the Group as reported under IFRS. This represents the excess of assets over technical provisions and other liabilities. It includes amounts that have yet to be formally declared as bonuses for the participating policy holders together with the free assets of the Group. Any profit of loss for the year is transferred to the surplus funds account.

UK regulations, the Group's Principles and Practices of Financial Management, and the terms and conditions of participating contracts set out the bases for the determination of the amounts on which the participating additional discretionary contracts benefits are based and within which the Group may exercise its discretion as to the quantum and timing of their payment to contract holders.

Reconciliation reserve

This reduces the tier 1 capital and represents surplus funds within ring fenced funds which are not available to the Group.

Subordinated liabilities

Details of the Group's the subordinated liabilities, which are included as tier 2 capital within own funds, together with the valuation methodology are given.

For the subordinated liabilities issues by the Society, there is an option of cumulative deferral of interest at the issuer's discretion and mandatory interest deferral in the event that a regulatory deficiency interest deferral event has occurred or is continuing (breach of the applicable regulatory solvency capital requirement of the issuer or group) or would occur if payment of interest on the subordinated notes were to be made. Following any deferral of a principal or interest payment, the Society would be prevented from declaring any distribution to members which falls within the Mutual Bonus arrangements. The Society has the option to elect to defer payment of interest in whole or in part and this will not constitute a default or give the right to the noteholders or the trustee to accelerate repayment of the Notes or to take any enforcement action.

Eligibility

For the SCR, the sum of the eligible amounts of Tier 2 and Tier 3 items shall not exceed 50 % of the SCR. For the MCR, Tier 3 capital items are not eligible and Tier 2 items shall not exceed 20 % of the MCR. The items which are classified as Tier 3 include other own funds not falling into Tier 1 or 2. Article 76 of the Delegated Acts specifies deferred tax assets as a Tier 3 capital.

Changes in own funds during the reporting period

	LVFS Group		
	1st January 2016 £m	Movement £m	31 st December 2016 £m
Eligible own funds			
Tier 1 capital	917	83	1,000
Tier 2 capital	370	15	385
Tier 3 capital	15	11	26
Total capital	1,302	109	1,411
Made up by:			
Surplus funds	1,001	116	1,117
Deferred tax	15	11	26
Reconciliation reserve	(84)	(31)	(115)
Subordinated liabilities	370	15	385
Minority interests	-	(2)	(2)
Total capital	1,302	109	1,411
Total eligible own funds to meet SCR	1,302	109	1,411

- Tier 1 capital includes movements in excess of assets over liabilities, adjusted for the movement in deferred tax and reconciliation reserve.
- Tier 2 capital represents subordinated debt.
- Tier 3 capital represents deferred tax asset.

Surplus funds have increased due to the Solvency II profit generated during the year. The reconciliation reserve comprises of adjustments (e.g. Ring Fenced Funds, Deferred tax etc.) to the capital elements used in the calculation of SCR.

d) Eligible own funds

The following tables detail the eligibility of own funds to meet the SCR and MCR.

	Tier 1	Tier 2	Tier 3	Total
Total available Own Funds to meet the Group SCR	1,000	385	26	1,411
Total eligible Own Funds to meet the Group SCR	1,000	385	26	1,411

Total available Own Funds to meet minimum Group SCR	1,000	385	26	1,385
Capital restrictions	-	(302)	26	(302)
Total eligible Own Funds to meet the minimum Group SCR	1,000	83	26	1,083

No own funds has been reported for the prior year as allowed by article 303 of the Delegated Regulations

e) Material differences between equity as shown in the financial statements and excess of assets over liabilities as calculated for solvency purposes.

LVFS is a friendly society and is incorporated under the Friendly Societies Act 1992. Unallocated divisible surplus represents the excess of assets over and above the long-term insurance contract liabilities and other liabilities. It represents amounts that have yet to be formally declared as bonuses for the participating contract policyholders together with the free assets of the Society. Any profit or loss for the year arising through the Statement of Comprehensive Income is transferred to or from the unallocated divisible surplus.

The following table provides a reconciliation of equity (unallocated divisible surplus) under IFRS to Solvency II excess of assets over liabilities.

	2016 £m
IFRS Unallocated divisible surplus	998
Deduct deferred acquisition costs, goodwill and other intangible assets and liabilities	(393)
Add subordinated debt treated as available capital	385
Insurance contract valuation differences	505
Deferred tax adjustments	24
Other	(19)
Less net eligible own funds relating to ring-fenced funds	(204)
Eligible own funds (excluding ring-fenced funds)	1,296
RNPFN – eligible own funds	139
Restriction of own funds in respect of RNPFN	(42)
Teachers – eligible own funds	65
Restriction of own funds in respect of Teachers	(47)
Total own funds (excluding ring fenced fund surplus)	1,411

Differences in the asset and liability valuation methodology used for solvency purposes and that used under IFRS are set out in Section D.

Any surplus own funds over the notional SCR of RNPFN and Teachers, which are both ring-fenced funds, are restricted so the Group does not benefit from these surplus funds.

f) Own-fund item subject to transitional arrangements

Within Tier 2 there is subordinated debt issued by Highway for EUR 12m in December 2004 which has an original maturity date of November 2034 and has the following terms and conditions;

- Ranks after the claims of all policy holders and beneficiaries and non-subordinated creditors
- Does not include features to cause insolvency
- Is only repayable at the option of Highway
- Includes no incentives to repay or redeem
- Allows the suspension of repayment or redemption of the debt if it would otherwise fail to meet SCR/MCR
- Provides for the distribution to be mandatorily deferred where there was non-compliance with SCR/MCR or where the distribution would lead to such non-compliance
- It was free from encumbrances and was not connected with any other transaction

Under the solvency II transitional rules the Highway subordinated debt is included in the Tier 2 category of Basic Own Funds for 10 years from 1st January 2016.

The Group's Own Funds have been calculated using the accounting consolidation-based method which is considered the default method. Intra-group transactions, balances and unrealised gains on intra-group transactions are eliminated on consolidation. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred.

In assessing whether certain own funds cannot be made available to cover Group SCR, the supervisory authorities shall consider the following elements:

- a) Are there legal or regulatory requirements restricting the transfer of assets to another insurance or reinsurance undertaking within the group.
- b) Can the own funds be made available within a maximum of 9 months of requirement.
- c) Are there costs associated with making such own funds available for the Group.
- d) The following cannot be used to cover Group SCR
 - Ancillary own funds
 - Preference shares, subordinated mutual members account and subordinated liabilities;
 - Net deferred tax assets
 - Any minority interest in a subsidiary ancillary services undertaking
 - Any minority interest in an insurance or reinsurance subsidiary which exceeds the contribution of that subsidiary to the Group SCR
 - Any restricted own funds in ring-fenced funds.

Not all assets within an undertaking are unrestricted. Certain products or activities result in ring-fenced fund structures which give one class of policy holder greater rights to assets within their own fund. Although these assets are included in computing the excess of assets over liabilities for own fund purposes, they cannot in fact be made available to meet the risks outside the ring-fenced fund. The Group has identified the Royal National Pension Fund for Nurses (RNPFN) and the Teachers With Profit fund as ring fenced funds which restrict the transferability of own fund items.

The Group has subordinated liabilities, net asset value attributable to external unit holders (minority interest) and net deferred tax assets. For further information refer to Valuation for Assets and Liabilities section of this report.

Accordingly restrictions in the transferability and fungibility of own funds in related undertakings arise from three main areas:

1. Solvency capital requirements at subsidiary undertaking level.
2. Ring Fenced Funds.
3. Regulatory restrictions in relation to subordinated liabilities, net deferred tax assets and minority interest

As the organisation is adopting standard formula for year-end 2016, no further information in respect of the Group's internal model is presented here.

The organisation does not have any material own funds issued by an equivalent third country insurance or reinsurance undertaking.

E.2 SCR and MCR

E2.1 Group SCR and MCR

The Society calculates its SCR using the accounting consolidation-based method set out as Method 1 in Article 230 of Directive 2009/138/EC. This values the Group on a look through basis, where the risks of all insurance subsidiaries are considered as if they belonged to the same legal entity. Capital requirements for non-insurance subsidiaries are then added on separately.

The Group SCR as at 31st December 2016 was £1,044m. The Group SCR increased over the reporting period largely due to the reduction in interest rates over the year, new business, and reduction in tax relief due to the Ogden discount rate change, partially offset by the implementation of the matching adjustment and capital optimisation activities.

The minimum consolidated Group SCR as at 31st December 2016 was £416m. The minimum consolidated Group SCR is the sum of MCRs of the individual entities (see sections E2.1 of appendices for further information). The reason for the increase in the minimum consolidated Group SCR over the year is the increased SCRs in the largest subsidiaries within the Group.

E2.2 Group SCR split by risk

The Society uses a Standard Formula approach for calculating its regulatory SCR, although it maintains its own internal view of capital. The following table shows the breakdown of the Group SCR by risk on the Standard Formula basis. In line with the construction of the Standard Formula SCR, the amounts for each risk module contain some diversification allowance within that module. For example the market risk line includes diversification between equity and interest rate risk. The individual modules also include an allowance for the loss absorbing capacity of technical provisions.

The below figures allow for the structure of the Group, and specifically RNPFN and Teachers Ring Fenced Funds. The capital requirements for these funds are calculated in isolation and added to those of LVFS, with no credit being taken for diversification between them.

Risk Module	£m
Market risk	476
Credit counterparty risk	45
Life underwriting risk	315
Health underwriting risk	86
Non-Life underwriting risk	473
Total before diversification	1,396
Diversification	(414)
Basic Solvency Capital Requirement	982
Operational risk	107
Loss absorbing capacity of deferred taxes	(46)
Other adjustments	2
Solvency Capital Requirement	1,044

E2.3 Diversification benefit

Diversification benefit within the SCR emerges from relative sizes of the risks and the correlation assumptions between them. The Society uses the Standard Formula approach to assess the Group SCR and, as such, the stress assumptions used to calculate the risk capital amounts, and the level of correlation between risks, are prescribed by Solvency II regulation.

The Society's Group SCR has material sources of diversification benefits arising from:

- life business written directly by the Society; and
- between the life business directly written by the Society and the general insurance business written within its subsidiaries.

The business written by the Society has different underlying risks, which contribute to the level of diversification within the SCR. For example, the Society's with-profits business diversifies against its protection business due to the different risks to which these businesses are exposed.

The business written by the Society also has a different risk profile to the general insurance business written by its subsidiaries, this offers another material source of diversification benefit within the SCR.

The RNPFN and Teachers with-profits funds and the Matching Adjustment Portfolio are ring fenced funds that do not diversify with other business in the Group.

E2.4 Basis of calculation

The Group uses a Standard Formula basis to calculate the SCR. The approach to calculating the SCR and MCR is in accordance with the Solvency II Directive. The Society is not using any material simplifications or undertaking specific parameters in the calculation of the SCR and does not have any regulatory capital add-ons.

E.3 Use of a duration-based equity risk sub-module

The Group has not applied the duration-based equity risk sub-module in the calculation of the SCR.

E.4 Differences between Standard Formula and any Internal Model used

This does not apply as the Group does not use an Internal Model to calculate its SCR.

E.5 Non-compliance with the MCR and the SCR

The Group, the Society and its subsidiaries were compliant with the respective MCR and SCR throughout the reporting period.

E.6 Any other material information

Further details on the insurance entities in the Group can be found in the relevant appendices.

LVFS Solo SFCR

A. Business and Performance (LVFS - Solo)

A.1 Business

a) Name and legal form of undertaking

Liverpool Victoria Friendly Society Limited is a UK-incorporated and domiciled Friendly Society registered under the Friendly Societies Act 1992.

For the contact details of LVFS please see part a) in chapter A1 of the Group section of this report.

b) Name and contact detail of the supervisory authority responsible for financial supervision.

Firm's reference number: 110035

The Prudential Regulation Authority is responsible for the financial supervision of the company, and the Group.

For the contact details of the PRA please see part b) in chapter A1 of the Group section of this report.

c) Name and contact details of the external auditor

For information on the external auditor of LVFS please see part c) in chapter A1 of the Group section of this report.

d) Description of the holders of qualifying holdings in the undertaking

For a description of 'qualifying holdings' please see part d) in chapter A1 of the Group section of this report.

As LVFS is a mutual organisation, there are no external qualifying holdings within the meaning of the Solvency II regulations.

e) Details of the undertakings within the group

For an explanation of the undertakings position within the group please see part e) in chapter A1 of the Group section of this report.

f) Material lines of business and material geographic areas.

Materially LVFS underwrites life insurance contracts within the UK.

Life:

The principal activity is the provision of protection and retirement solution products. The core products offered in protection are Life, Critical Illness, Income Protection and Unemployment Insurance while the core products offered in retirement solutions are Annuities, Self-Invested Personal Pensions (SIPPs), Equity Release Mortgages and Flexible Guarantee Bonds.

Heritage:

This segment focuses on savings and investment products that are no longer actively marketed, the majority of these being with profit products.

g) Significant business or other events occurring during the reporting period that have a material impact on the undertaking.

Business and Performance

The Society reported an IFRS profit before tax, mutual bonus and unallocated divisible surplus transfer of £47m for the year (2015 £118m). The result benefited from good trading profits in the life business. The result included a £33 million loss in the heritage business generated by changes made to the reserving assumptions, partially reversing the £88 million benefit arising in 2015.

Capital position and changes in risk profile

At 31st December 2016 the Solo capital surplus on a standard formula basis was £688m (a CCR of 202%) compared to £543m as at 1st January 2016 (CCR of 172%).

In July 2016, the PRA confirmed that the group's preparations for Internal Model were sufficiently advanced to allow it to proceed to making an application for Model approval. LV= submitted an application for Internal Model approval in the first quarter of 2017. Internal Model will only be implemented following PRA review and approval.

The Society secured PRA approval in April 2016 to apply the Matching Adjustment to the majority of its annuity business. The inclusion of the Matching Adjustment forms an integral part of the Group's approach to Asset and Liability Management.

The Society has also received PRA approval to apply Transition (also known as Transitional Measure on Technical Provisions or TMTP) and Volatility Adjustment from 1st January 2016. Transition provides firms with relief from day 1 from the financial impact on Technical Provisions of moving to the new Solvency II regime. The relief then amortises annually over 16 years. The PRA also allows firms to apply for permission to recalculate Transition, subject to certain trigger conditions, to take account of matters such as market movements or changes to a firms' risk profile.

The Society applied to and was granted by the PRA permission to recalculate Transition as of 29th April 2016, triggered by the move to use the Matching Adjustment, and as of 31st August 2016 due to changes in the business risk profile.

There was also an industry-wide recalculation on 30 June 2016 as a result of market movements. The net effect of the recalculations in the year has been to offset the adverse impacts of changes in business risks, including interest rates, on eligible own funds by some £281 million.

The Society's risk profile and capital position were significantly affected in the year by volatility in long term interest rates and the spread between gilts and swap rates, particularly after the result of the EU Referendum. As a result the Society has put in place a number of interest rate and basis risk hedges to manage these risks and to protect its capital position. The Society also put in place reinsurance to reduce its exposure to longevity risk in enhanced annuities and OB Pensions. In addition the Society took the decision in the second half of the year to cease writing enhanced annuities, a capital consumptive product.

System of Governance

There have been no significant changes in the Society's system of governance in the year. The table below summarises the changes in membership of the Board in the year:

D Barral – appointed 7 March 2016
J O'Roarke resigned from the Board on 5 May 2016.
S Treloar - appointed 05 May 2016
M J Rogers - resigned 28 July 2016.
R Rowney – (previously managing director life and pensions) appointed as CEO 28 July 2016

Legal and regulatory environment

Following publication of final guidance, FCA have finalised their expectations of firms treating long standing customers. The FCA are of the view that the industry has not delivered to customer expectations, and as a result all firms will need to review their processes and communications thoroughly to ensure ongoing compliance with their requirements. LV= has a well-established project that has clarified the ongoing activity required and estimated the cost of this activity, including the delivery of the programme of changes as well as the cost of remediating customers as appropriate. However, there is a risk that there is further remediation work not currently identified. The Society has been reviewing legacy products for a number of years and has made a number of changes in the past to improve the treatment of these customers so assesses this risk as low.

As a result of pensions freedoms, the Society has seen an increased demand for customers seeking to leave defined benefit schemes in favour of the more flexible benefits now available in defined contribution arrangements. The Financial Advice business (FAS) is operating in this market under strict controls, as this activity is high risk. The FCA have commenced a thematic review into this activity, in which LV= is participating, which could result in a change in regulatory requirements.

2016 Financial Performance

Basis of preparation

The income statements for the years ended 31st December 2016 and 31st December 2015 are based on the IFRS financial statements adjusted for presentational adjustments made in the LVFS QRTs. Profit before tax is the same under both presentations.

LVFS £m	2016	2015
Net earned premiums	967	803
Net claims incurred including changes in other technical provisions (excluding claims handling costs) ¹	(2,129)	(613)
Expenses incurred (including claims handling costs and excluding investment management expenses)	(198)	(186)
Net underwriting result	(1,359)	4
Investment gains/ losses	1,400	102
Other income	12	8
Finance costs	(23)	(23)
Profit / (loss) before tax and UDS transfer	30	91
Tax	(45)	1
Pension scheme	(2)	51
Profit / (loss) after tax and before UDS transfer	(17)	143

¹ Net claims incurred includes the mutual bonus of £17m (2015: £27m)

All income statement numbers presented in Section A are based on the IFRS Financial Statements adjusted for certain presentational adjustments made in the QRTs. Profit before tax is the same under both presentations.

LVFS is split into two business areas, life and heritage.

Life has seen new business volumes grow across all product segments, with the increase in contribution from this new business helping to drive profit. There have also been favourable one-off model and valuation changes in the year, mainly driven by savings from reduced unit costs in the protection business as volumes increase. During the year the business took out an annuity reinsurance treaty in order to strengthen the group capital position which had an adverse impact on the life result of £14 million.

The heritage business has seen a loss driven by model and valuation changes relating to the OB pensions payout basis and cash take-up rate and unit costs of £22 million and claims experience variances of £11 million; mainly generated by additional payments made to ensure policyholders are treated in line with the Principles and Practices of Financial Management (PPFM).

A.2 Underwriting performance

Underwriting performance by line of business compared to previous reporting period

The following tables provide further information on IFRS underwriting income and expenses analysed by material lines of business:

2016	Health insurance	Insurance with profit participation	Index-linked and unit-linked insurance	Other life insurance	Other	Total
	£m	£m	£m	£m	£m	£m
Net earned premiums	47	609	-	311		967
Net claims incurred including changes in other technical provisions	(19)	(1,169)	(345)	(595)		(2,129)
Expenses incurred (excluding investment management expenses)	(47)	(20)	(21)	(81)	(29)	(198)
Net underwriting result	(19)	(580)	(366)	(365)	(29)	(1,359)

2015	Health insurance	Insurance with profit participation	Index-linked and unit-linked insurance	Other life insurance	Other	Total
	£m	£m	£m	£m	£m	£m
Net earned premiums	44	421	-	338		803
Net claims incurred including changes in other technical provisions	36	(194)	(269)	(186)		(613)
Expenses incurred (excluding investment management expenses)	(46)	(20)	(20)	(78)	(22)	(186)
Net underwriting result	35	207	(289)	73	(22)	4

Income and expenses in the above tables are on an IFRS basis but have been aligned to QRT S.05.01. Claims management expenses are moved from net claims incurred to expenses incurred. Investment management expenses are moved from expenses incurred in to investment performance.

2016 net earned premiums grew by 20% compared to 2015 predominantly driven by strong new business sales across all life product categories. The increase in gross earned premiums was mitigated at a net earned premium level by increases in reinsurance ceded. Additional reinsurance treaties have been introduced for annuities as one of several management actions during the year to manage risk and protect the Solvency II capital position.

All business is underwritten in the UK.

A.3 Investment performance

The following table summarises the income and expenses with respect to investment activities, on an IFRS basis, during the last reporting period:

	2016	2015
	£m	£m
Dividend income	139	108
Interest income	267	264
Net realised and unrealised gains/(losses)	1,013	(247)
Gain arising on Teachers acquisition	3	0
Less investment management expenses	(22)	(23)
Total Investment Performance per IFRS	1,400	102

The below analysis provides a reconciliation of 2016 investment performance between the amounts reported in the financial statements and the QRTs respectively.

	2016
	£m
Total Investment Performance reported in the financial statements.	1,400
Collective investment management fee rebate (not treated as income in the QRTs)	(8)
Total Investment Performance reported in QRTs	1,392

Investment income of £1,392m was £1,286m higher than 2015 driven by a £1,278m increase in realised and unrealised gains in the year in equities, government bonds and corporate bonds, reflecting reductions in long term interest rates and spreads and strong UK equity markets in particular. Investment income includes £64m of intra-group income (2015: £49m).

The following table summarises the undertaking's overall investment performance during the reporting period and also by relevant asset class:

2016 Asset class (£m)	Dividends	Interest	Net gains and losses	Total	Percentage of Total	Average investment holding during 2016	Average investment return
Government bonds		63	268	331	23.4%	2335	14.2%
Corporate bonds		89	114	203	14.4%	2157	9.4%
Equity	93		117	210	14.9%	884	23.8%
Collective investment undertakings	61		441	502	35.5%	2351	21.4%
Collateralised securities		8	15	23	1.6%	111	20.7%
Cash and deposits		2	-	2	0.1%	316	0.6%
Mortgage and Loans		67	77	144	10.2%	797	18.1%
Call & Put options, Swaps, Futures			(1)	(1)	-0.1%	137	-0.7%
Total	154	229	1,031	1,414			
Less investment expenses				(22)			
Net total				1,392			

The investment performance for the year is primarily driven by the movement in net gains on investments to £1,031 m compared to net losses of £247m in 2015.

Investment in securitisations.

There is currently £8m held with one provider which has been classified as securitisation. This represents 0.07% of the total investments held at the end of 2016. The value of this investment class is monitored on a quarterly basis.

A.4 Performance of other activities

LVFS £m	2016	2015
Loan / finance interest charge	(23)	(23)

LVFS issued fixed rate reset subordinated notes at par of £350m on 22nd May 2013. This debt has a maturity date of 22nd May 2043 but the issuer has the option to redeem the notes at the first call date of 22nd May 2023 and at five yearly intervals thereafter up to the maturity date

Leasing arrangements

Finance lease commitments

Finance lease commitments of £20m relate to a property with a remaining lease term of 24 years. The lease is on a fixed repayment basis and no arrangements have been entered into for contingent payments. The Group's obligations under finance leases are secured by the lessors' charges over the leased assets. See note 41 of the 2016 Annual Report and Accounts for more information.

A.5 Any other information

There is no additional information to disclose for section A.

B. System of Governance (LVFS - Solo)

The system of governance for LVFS is described in Section B of the Group section of this report.

C. Risk Profile (LVFS – Solo)

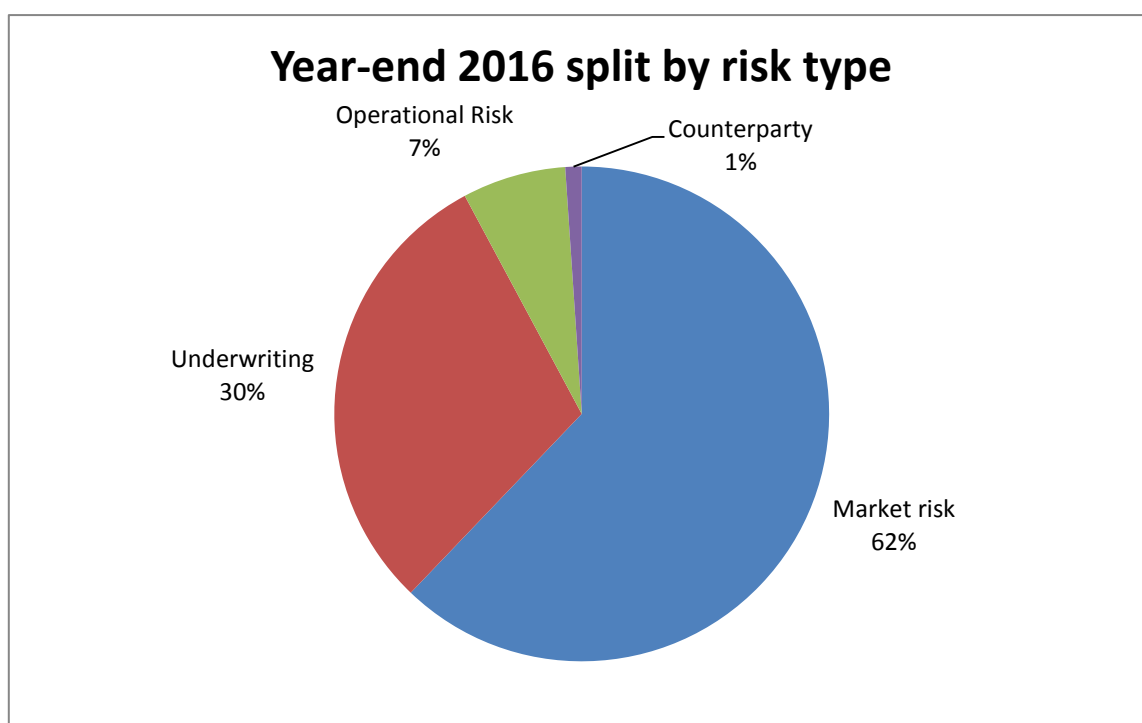
C.1 Overview

C.1.1 Overview of risk exposures

As an insurance company the Society's business model involves taking on risk for its policyholders, in order to provide security and aid in financial planning. In order to facilitate this LV= offers a range of Life and Health insurance products. These cater to differing policyholder needs and a widely diversified customer base in terms of age, gender and geographical location.

The risks of the Society are managed in the same way as those of the Group, and details can be found in that section of this report.

The chart below shows the year-end 2016 split of the Standard Formula Solvency Capital Requirement (SCR) by risk type. The largest exposures relate to market risk (62%) and underwriting risk (30%)



C.1.2 Measurement of risk exposures

Risk exposure and management are managed in a similar way for the Society as for the Group. These include regulatory reporting, internal capital assessments and experience analysis. Further details can be found in the Group section of this report.

C.1.3 Prudent person principle

LVFS operates within a wider LV= Group defined investment framework which ensures that all assets are invested in accordance with the prudent person principle. Further details can be found in the Group section of this report.

C.1.4 Risk concentration

The Society offers a wide range of product options catering to differing policyholder needs and a widely diversified customer base in terms of age, gender and geographical location. As such the Society has a diverse and balanced mix of business and risk exposures. As the Group has substantially written all of its business in the UK, results are sensitive to demographic and economic changes arising in the UK.

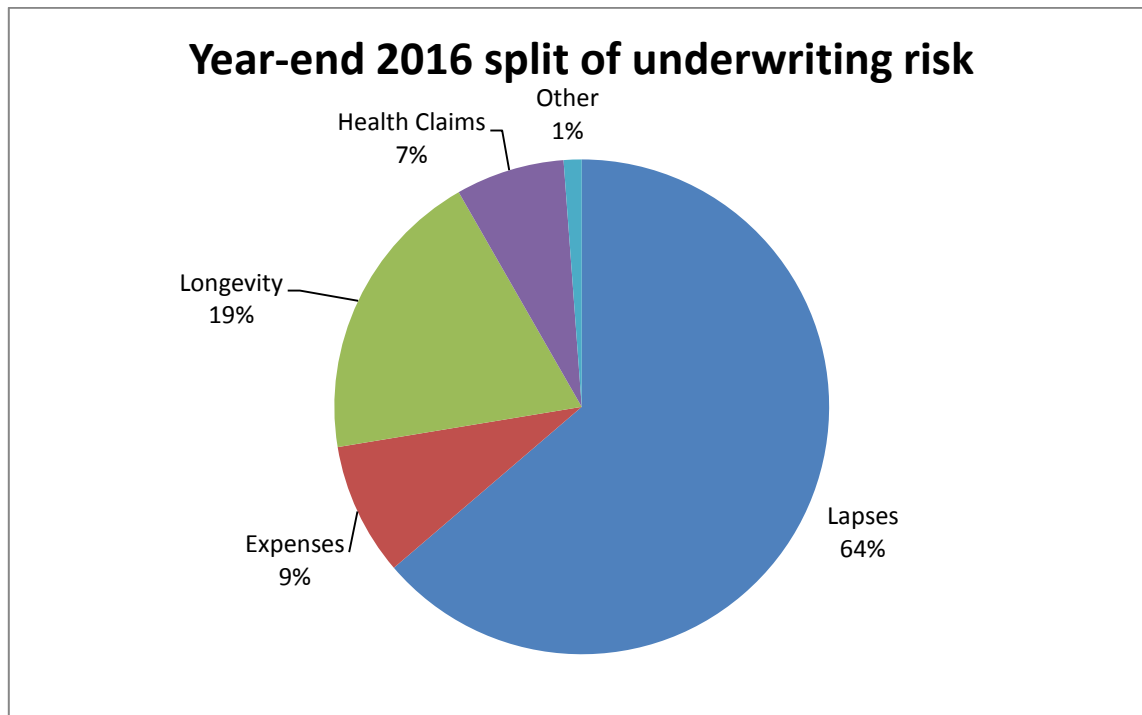
The Society uses a variety of measures to limit any excess concentrations. These are described in more detail in the Group section of this report.

Where material, further information on risk concentrations relating to particular risks are given in sections C2 to C7 below.

C.2 Underwriting risk

C.2.1 Underwriting risk exposure

The Society writes the majority of Life and Health business within the Group and is exposed to Underwriting risk in these areas. Non-life business is not written in the Society, but instead in its subsidiaries LVIC, Highway and LVPL. The chart below shows the split of underwriting risks within the solo SCR at year-end 2016.



- The largest single risk exposure is in respect of lapse risk. This is a significant issue across the life insurance industry, due to the long term nature of the business and relative importance of future premiums, charges and claims upon profitability. As a result lapse rates on material product lines are closely monitored.
- Longevity risk arises primarily from immediate and deferred annuities, partially mitigated by reinsurance.
- Expense risk affects all business lines and covers the possibility of higher than expected expenses, for example due to inflation or regulatory change.
- Health risk arises from policies which pay out on a range of health or morbidity related criteria, for example on diagnosis of a serious illness or on loss of earnings due to illness.
- The remaining risks include the risk of higher than expected mortality risk and life catastrophe risk such as pandemics. These risks are relatively minor for the Society, being either small in nature, heavily reinsured, or heavily diversified.

C.2.2 Material changes over the reporting period

During 2016, the level of longevity swap cover on enhanced annuity policies was increased, leading to a significant fall in longevity risk over the period.

Yields also had a significant impact on the risk profile, as interest rates fell over the year following the Brexit announcements. This led to increases in the capital required for life underwriting risks particularly lapse risk.

C.2.3 Risk mitigation techniques

Reinsurance is used as a risk mitigating technique across a range of products to transfer mortality, morbidity and longevity risk outside of the Society. Further details can be found in the Group section of this report.

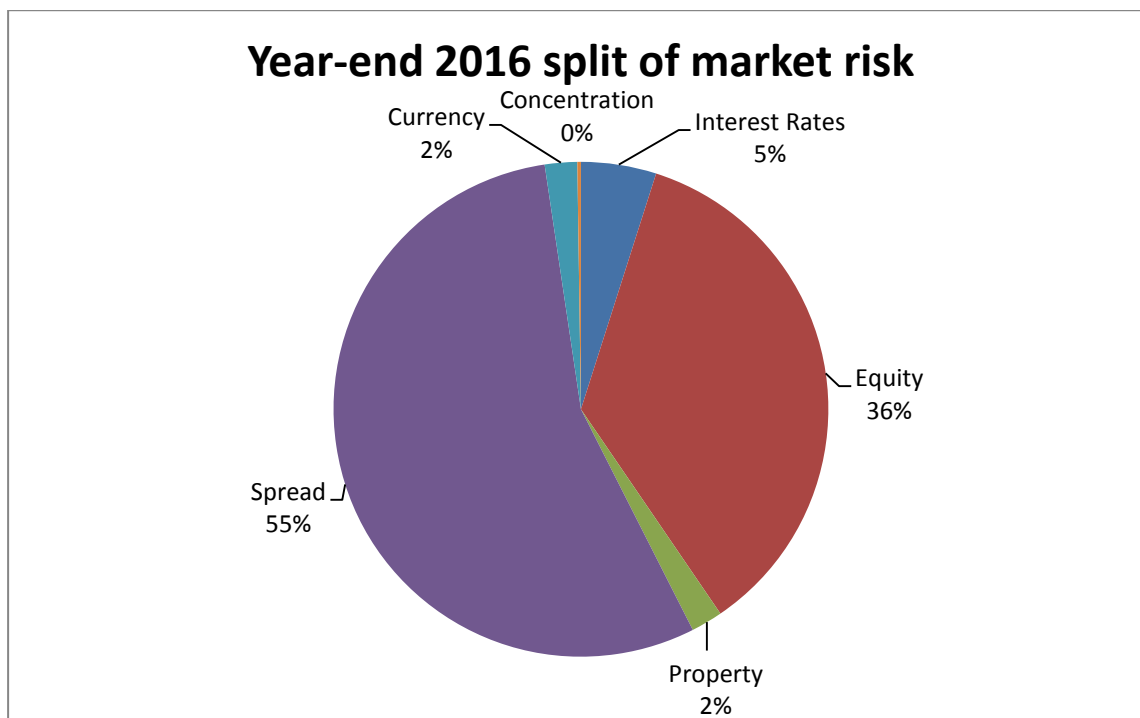
C.2.4 Risk concentrations

The Group has developed its insurance underwriting strategies to diversify the type of insurance risks accepted and within each of these categories to achieve a sufficiently large population of risks to reduce the variability of the expected outcome. Further details can be found in the Group section of this report.

C.3 Market risk

C.3.1 Market risk exposure

As an institutional investor the Society invests in a range of assets and these investments are governed by mandates and limits set by the Society. The chart below shows the split of market risk within the year-end 2016 SCR.



The market risks LVFS is exposed to are similar to those observed by the Group, although they exclude the assets in subsidiaries. Instead subsidiaries are valued on a “Solo” basis, where the Society’s debt and equity holding in each subsidiary is treated as an asset.

The Society is exposed to the following material market risks:

- Spread risk is a significant risk for the Society as it has a high exposure to corporate bonds. This arises primarily from the enhanced and fixed annuity business, where corporate bonds are used to back a large proportion of the liabilities. There is also a material contribution to spread risk from the defined benefit pension schemes, which invest a significant proportion of their assets in corporate bonds. Spread risk also arises from the Society’s equity release mortgages. As a major risk, spread risk is considered in more detail within the Society’s internal view of risk, where alternative calibrations and approaches (such as looking at the yield of gilts above swaps) are considered.
- Equity risk arises primarily from the defined benefit pension schemes and the Society’s with-profits business. For the pension schemes, investment returns have no direct impact on scheme members’ benefits, so any reduction in equity values reduces surplus. For with-profits business, falls in equity markets increase the costs associated with guarantees.
- Interest rate risk is present under all lines of business, as the level of best-estimate liabilities are calculated by discounting future cashflows.
- Property risk arises mainly from the with-profits business and from the Society’s pension schemes. Property risk also arises from the Society’s equity release mortgage portfolio but this is not reflected within the Standard Formula calculation of the SCR. The Society monitors the property risk associated to equity release mortgages using its internal view of capital.
- Currency or foreign exchange risk. The Society has only a limited exposure to foreign exchange risk through its investment in overseas assets.

C.3.2 Material changes over the reporting period

The material changes over the period are the same as those described in the Group section, notably approval of the Matching adjustment, the Teachers acquisition and market movements.

C.3.3 Risk mitigation techniques

LVFS uses derivatives as part of its management of market risk. Derivatives are currently used to manage interest rate risk and equity risk. These are described in more detail in the Group section.

C.3.4 Risk concentrations

Equity risk is managed by investing in a diverse portfolio of high quality securities, this ensures that holdings are diversified across industries. Concentrations in any one company or industry are limited by parameters established by the Investment Committee. The exposure to property risk, from equity release mortgages, is managed through limits on the maximum loan to value ratio and seeking to limit concentrations in particular geographic areas.

C.4 Credit counterparty risk

C.4.1 Credit counterparty risk exposure

The principal risk that the Society is exposed to is default of an external counterparty. This risk arises in a number of areas:

- The default of assets the Society has invested in, including derivatives. This is both for monies invested by the Society and monies invested on behalf of policyholders.
- The default of reinsurers, to the extent that the reinsurer owes money to the Society. Given reinsurance is a key risk mitigation, any actual default in a reinsurer would impact the Society's capital position.
- The default of insurance intermediaries on money owed to the Society.

Credit counterparty risk is managed using the same policies and limits described in the Group section.

C.4.2 Material changes over the reporting period

Changes to Credit Counterparty risk in 2016 were small, and did not materially affect the Capital position.

C.4.3 Risk concentrations

In order to avoid exposure to a single default, LV= monitors its concentration to individual counterparties on a quarterly basis. This enables management decisions such as investment strategy or reinsurance deals to be evaluated against the total exposure of the Group, and LV='s Risk Appetite.

C.5 Liquidity risk

Liquidity risk is the risk of having insufficient liquid assets to settle financial obligations when they fall due. The risk exposure is managed using the same techniques as used for Group, and further details are available in that section. The expected profit in future premiums (EPIFP) for the Society at year end was just over £265m.

C.6 Operational risk

Operational risk is the risk of loss arising from inadequate or failed internal processes, personnel or systems, or from external events. Operational risk arises as a natural consequence of business activity and is managed actively within LVFS. Further details can be found in the Group section.

C.7 Other material risks

Capital requirements focus on known and quantifiable material risks. Some risks are not quantified, such as liquidity risk which is managed as described in section C5. Risk may also arise from unknown sources, and as a result the Society reviews its internal view of risk and capital on a regular basis to ensure the best quality of information is available for decision making. Differences between the Society's internal view of capital and the regulatory view capital include a more in depth view of certain risks such as spread risk and longevity risk, and additional risks such as asset manager's discretion risk. An ongoing dialogue is maintained with the PRA, including regular submissions of our Own Risk and Solvency Assessment.

C.8 Sensitivities

C.8.1 Economic sensitivities

Large components of the Society's exposure to economic sensitives are the same as Group, either through direct changes in assets and liabilities, or through the values of subsidiaries. The key difference is on the SCR, where impact analysis is not carried out on a Solo basis.

The below sensitivities have been carried out on the same basis as those in the Group section, but exclude the impact on the SCR. They thus contain similar approximations and should only be treated as estimates which give a broad indication of the direction and magnitude of the change in Own Funds in response to market movements. More detail on the sensitivities and exposures are shown in the Group section of this report.

Sensitivities		Impact
Item	Size	£m
Surplus capital at 31 st Dec 2016		688
Equities	10% market fall	(41)
Interest rates	25 bp fall	(21)
Interest rates	25 bp rise	21
Gilt swap spreads	25 bp rise	(52)
Credit spreads	50 bp rise	73

C.8.2 Demographic sensitivities

The majority of Life and Health business is written in LVFS, and as a result the sensitivities are materially similar to those that appear in the Group section of this report (Group Section C.8.2). All non-life business is written in subsidiaries and further details can be found in the sections for LVIC and Highway.

C.9 Additional information on risk profile

Further information can be found on an IFRS basis within the Capital Disclosure note of the Report and Accounts.

D. Valuation for Solvency Purposes (LVFS - Solo)

D.1 Assets

For solvency valuation purposes, assets and other liabilities are valued consistently with IFRS provided that IFRS valuation methods are consistent with Article 75 of Directive 2009/138. Assets and other liabilities represent the fair value amount for which they could be exchanged between knowledgeable willing parties in an arm's length transaction.

The financial statements for LVFS have been prepared in accordance with:

- International Financial Reporting Standards (IFRS), as endorsed by the European Union ('EU')
- International Financial Reporting Interpretations Committee ('IFRIC')
- Statement of Recommended Practice issued by the Association of British Insurers (2005), amended 2006
- Friendly Societies Accounts and Related Provisions Regulations 1994; and
- those parts of the Companies Act 2006 applicable to companies reporting under IFRS.

	Note	2016			
		IFRS	Presentational adjustment	Solvency valuation adjustment	Solvency
		£m	£m	£m	£m
Intangible assets	#	11	-	(11)	-
Pension benefit surplus	1	134	-	-	134
Property, plant and equipment held for own use	#	9	-	-	9
Investments (other than assets held for index-linked and unit-linked funds)					
- Property (other than for own use)	3	5	-	-	5
- Participations	2,3	802	119	(385)	536
- Equities	3	3,223	(2,352)	-	871
- Bonds	3	4,687	364	-	5,051
- Collective Investment undertakings	3	3,051	(319)	-	2,732
- Derivatives	3	179	-	-	179
- Deposits other than cash equivalents	3	18	19	-	37
Assets held for index-linked and unit linked	4	-	2,001	-	2,001
Loans and mortgages	5	882	2	-	884
Reinsurance recoverables	6	601	562	(490)	673
Insurance and intermediaries receivables	#	4	-	-	4
Reinsurance receivables	#	11	-	-	11
Receivables (trade, not insurance)	#	136	(5)	-	131
Cash and cash equivalents	7	469	(326)	-	143
Any other assets, not elsewhere shown	8	100	(65)	-	35
Total Assets		14,322	-	(886)	13,437

= Disclosure note not provided as solvency value equal to IFRS or the amounts are immaterial.

Supporting Notes

1. Pensions Benefit Surplus

For solvency purposes, any pensions benefit surplus is valued consistently with IFRS.

Under IFRS, any Pensions Benefit Surplus is valued under IAS19, whereby the net surplus or deficit is calculated annually with the assets valued at fair value and the liabilities discounted at the rate of return available on high quality corporate bonds. The net surplus, to the extent recoverable or deficit is recognised as a pension benefit asset or liability in the Statement of Financial Position. No separate liability for funding requirements is recognised as the Society has an unconditional right to any of the assets of the pension schemes which would remain following the schemes' termination

2. Participations

Under IFRS participations are held at cost less any provision for impairment. For solvency valuation purposes certain investments are not consolidated and are valued as participations.

Participations	£m
Shares in subsidiaries	496
Loan stock in subsidiaries	306
Investments in group undertakings - IFRS	802
Joint venture properties reclassified as participations	119
Adjusted equity method valuation differences	(385)
Participations - solvency	536

Participations are valued using the Adjusted Equity Method (see Investments below)

3. Investments

For Solvency II valuation purposes, financial assets are valued consistently with IFRS. However there are also there are mapping differences between the IFRS and Solvency II hierarchies which certain assets such as Collective Investment Undertakings are presented differently under IFRS.

Under IFRS, financial assets are valued at fair value through income which has two sub categories:

- Financial assets held for trading; and
- Those designated at fair value through income at inception.

Derivatives are classified at fair value through income as they are held for trading. Financial assets designated at fair value through income at inception are measured at market prices, or prices consistent with market ratings should no price be available. Day one gains are recognised only where valuations use data from observable markets. Any unrealised or realised gains or losses are taken to the Statement of Comprehensive Income, as fair value gains or losses, or realised gains or losses respectively, as they occur.

Financial assets at fair value through income; further information is provided in the table below.

Fair value estimation

For solvency valuation purposes, the fair value measurement hierarchy is as follows:

- Quoted market prices in active markets for same assets and liabilities (QMP). This is the default valuation method and is broadly consistent with Level 1 category assets under IFRS.
- Quoted market price in active markets for similar assets (QMPS). Maximum use is made of relevant market inputs such as quoted prices for identical or similar assets in an inactive market, observable inputs other than quoted prices and market corroborated inputs derived from observable market data. This is broadly consistent with Level 2 category assets under IFRS.
- Other alternative valuation method (AVM). Unobservable inputs reflecting the assumptions market participants would use when pricing the asset or liability, including assumptions about the risk inherent in both the inputs and the valuation technique. The undertaking uses various valuation approaches, including market, income and cost approaches. This is broadly consistent with Level 3 category assets under IFRS.
- Adjusted Equity Method (AEM) for Participations

The following table presents the financial assets measured at fair value at 31st December 2016.

	QMP £m	QMPS £m	AVM £m	AEM £m	Total £m
Bonds	2,779	2,272			5,051
Equities	817			116*	933
Equities Unlisted			174		174
Collective Investment Undertakings	2,658	75			2,732
Derivatives		179			179
Loans and mortgages			884*	300 #	1,185
Property, plant and equipment (held for own use)			9		9
Property			5		5
Investments (other than assets held for index-linked and unit-linked funds)	6,254	2,526	1,072	416	10,268

4. Assets held for index-linked and unit linked funds

Under IFRS, assets held for index-linked and unit linked funds are included in financial assets at fair value through income. For solvency valuation purposes, these assets are valued consistently with IFRS but are reported separately.

5. Loans and Mortgages

For solvency valuation purposes, loans and mortgages are valued consistently with IFRS with a reclassification adjustment for accrued interest which is included in investments rather than accrued interest.

Under IFRS, loans and mortgages are included in financial assets at fair value through income.

	£m
Equity release mortgages	684
Commercial mortgages	198
Total included in Financial assets at fair value through income - IFRS	882
Reclassify accrued interest on commercial mortgages from accrued interest	2
Total Loans and Mortgages -solvency valuation	884

Equity release mortgages

Equity release mortgages are not actively traded in a secondary market and hence a mark-to-model valuation approach is used which is classified as other Alternative Valuation Method (AVM). (Please see note 6 Investments for full definition of AVM and Section D4). The fair value of the Equity Release mortgage assets is determined using a discounted cash flow model which takes into account the contractual rate of interest charged on the loans, the expected mortality and morbidity of the mortgagor and mortgagor actions.

The discount rate is the zero-coupon swap curve with adjustments for profit and liquidity premiums.

Commercial mortgage valuation

The fair value of the loans secured on commercial property is determined using discounted cash flows to reflect changes in underlying gilt yields and debt margins. Where the value is not expected to be recovered through ongoing loan payments, the fair value represents the recoverable value of the property in the market post transaction costs.

6. Reinsurance recoverables

The undertaking cedes insurance risk in the normal course of business. Reinsurance assets represent balances recoverable from reinsurance companies.

For Solvency II valuation purposes, reinsurance recoverables are valued using the cash-flow projection method and in a consistent manner with the calculation of the best estimate liabilities. See the technical provisions information later in this section for a description of how the reinsurance recoverables are calculated.

7. Cash and cash equivalents

For solvency valuation purposes, cash is valued consistently with IFRS with a reclassification adjustment for short term bank deposits which are included in investments (other than assets held for index-linked and unit-linked funds) as deposits other than cash equivalents.

Under IFRS, cash and cash equivalents comprise cash at bank and in hand, and short-term deposits with an original maturity of three months or less. These are valued at fair value based on amounts receivable on demand.

	£m
Bank Balances	144
Short term bank deposits	325
Total cash and cash equivalents -IFRS	469
Reclassify short term deposits into bonds	(325)
Reclassify short term deposits into assets held for index-linked and unit-linked contracts	(1)
Total cash and cash equivalents solvency valuation	143

8. Any other assets, not shown elsewhere

For solvency valuation purposes, prepayments and accrued income are valued consistently with IFRS. On the Solvency II balance sheet, the accrued interest on bonds is included in the market value of Investments.

Under IFRS, prepayments and accrued income balances are all due within one year. These are valued at fair value based on amounts receivable on demand.

	£m
Accrued interest	75
Other prepayments and accrued income	25
Prepayments and accrued income - IFRS	100
Reclassify accrued interest to Investments (excluding assets held for index-linked and unit-linked funds)	(65)
Total any other assets, not elsewhere shown - solvency valuation	35

D.2 Technical provisions

Technical provisions by line of business

The following table sets out the LVFS technical provisions split by Solvency II lines of business as at 31st December 2016.

Line of Business	31 st December 2016 - £m			Total Technical Provisions
	Best Estimate Liability (BEL)	Risk Margin (RM)	Transitional Measures on Technical Provisions (TMTP) - unaudited	
Insurance with-profits participation	5,575	120	(343)	5,351
Index-linked and unit-linked insurance	2,519	9	(11)	2,517
Other life insurance (including Health)	3,840	147	(556)	3,431
Total Life insurance obligations	11,933	276	(910)	11,300

Technical provisions methodology and assumptions

All of the life business within the LVFS Group is written directly within LVFS (other than a very small amount of protection business within LVLC). A full description of the bases, methods and assumptions used for valuation of the life technical provisions within LVFS can therefore be found in section D2.2.2 of the Group part of this report and is not reproduced here.

Impact of the Matching Adjustment, Volatility Adjustment and Transitional Measure on Technical Provisions (TMTP only -unaudited)

The impact of not applying the MA, VA or TMTP is set out in S.22.01.21.

Uncertainty within the Technical Provisions

The calculation of Technical Provisions use established actuarial and statistical techniques that represent a best estimate of expected realistic future cash flows and liabilities. These calculations are nevertheless based on data, assumptions and models, which may not reflect actual future experience. In addition some simplifications are used where appropriate. As such a level of uncertainty is associated with these results. Further details on notable areas of uncertainty are set out in the Group section of this report.

Comparison of Solvency II and IFRS Technical Provisions

The table below shows the difference between the gross technical provisions under both Solvency II and IFRS.

Technical Provisions (gross)	Solvency II value £m	IFRS value £m	Difference £m
Insurance with-profits participation	5,351	5,689	(338)
Index-linked and unit-linked insurance	2,517	2,521	(3)
Other life insurance (including Health)	3,431	4,483	(1,052)
Total Life insurance obligations	11,300	12,693	(1,393)

Risk Margin and TMTP are significant sources of difference between Solvency II and IFRS; there is no equivalent in the latter. The Risk Margin and TMTP are explored earlier in section D2.2.2 of the Group part of this report.

The other primary differences between Solvency II and IFRS are as below.

Discount rates: Whilst the risk-free reference curve under IFRS is the gilt curve, under Solvency II, the rates are prescribed by EIOPA and are derived from swap rates. Additionally, under Solvency II, the Society makes use of the VA and MA which allow the liabilities of some Life business to be discounted at a higher than risk-free rate. There is no equivalent to the VA under IFRS but the illiquidity premium, which represents compensation for risks not borne by a portfolio of 'hold to maturity' assets (as is the case with annuity business), that is used for IFRS is broadly similar to the MA.

Prudent margins: These exist under IFRS to allow for uncertainty. Under Solvency II, uncertainty is allowed for within the SCR.

Present value of future profits: Under IFRS, non-profits business technical provisions are calculated with margins for adverse deviation, and separately, the value of the release of these margins is calculated (PVFP). This separation is not present in the direct BEL calculation under Solvency II, which contain a purely best estimate projection of future cash flows.

Surplus in closed funds: There is a presentational difference for the surplus in closed funds; under IFRS this is a liability whereas under Solvency II it is an adjustment to Own Funds.

Contract boundaries exist under Solvency II but not IFRS; however, they are not a material source of difference for the Society.

Description of reinsurance recoverables

The BEL was calculated gross without deduction of amounts recoverable from reinsurance contracts. The calculation of recoverable amounts was carried out separately for reinsurance contracts as the probability-weighted average of the discounted future cashflows allowing for contract boundaries. The assumptions and models used were the same as those used for the BEL, described earlier in this section.

The reinsurance recoverables were reported as a reinsurance asset on the balance sheet and include a deduction for the risk of reinsurer default.

Existing reinsurance programmes were assumed to renew where applicable. No allowance was made for any future reinsurance purchases that may be used to cover existing obligations where applicable or for future business in the BEL that was expected to be written under the treaties.

The Matching Adjustment was calculated using liability cash-flows gross of reinsurance, noting that the methodology allows for longevity swap recoverables in the asset cashflows.

There were no Special Purpose Vehicles (SPVs) in the Society.

Material changes in assumptions

The basis for the valuation of OB Pensions benefits, when taken as a cash settlement rather than an annuity, has been reassessed.

The PRA approval of the matching adjustment resulted in a significant reduction in Technical Provisions (before TMTP) and also a reduction in the level of TMTP. Details of the Matching adjustment are covered above and in the Group section of this report.

The calculation of the insurance contract liabilities is impacted by changes in unit costs. A review of the methodology has been carried out in 2016 and the revised expense assumptions have been adopted.

D.3 Other liabilities

	Note	2016			
		IFRS	Presentational adjustment	Solvency valuation adjustment	Solvency
		£m	£m	£m	£m
Provisions other than technical provisions	#	11	-	-	11
Deferred tax liabilities	#	73	-	-	73
Derivatives	#	236	-	-	236
Debts owed to credit institutions	#	116	-	-	116
Insurance and intermediaries payables	1	19	-	45	64
Reinsurance payables	#	2	-	-	2
Payables (trade, not insurance)	2	156	-	(13)	143
Subordinated liabilities	3	347	-	26	373
Any other liabilities, not elsewhere shown	#	5	-	(2)	3
Total Other Liabilities		965	-	56	1,021

#= Disclosure note not provided as solvency value equal to IFRS or the amounts are immaterial.

Supporting Notes

1. Insurance and intermediaries payables

For Solvency II valuation purposes, debts owed to credit institutions are valued consistently with IFRS. However there are also there are mapping differences between the IFRS and Solvency II hierarchies which certain assets such as Collective Investment Undertakings are presented differently under IFRS.

Under IFRS, insurance payables are recognised when due and include amounts due to policyholders, agents, brokers and intermediaries. Where there is objective evidence that the carrying value is impaired then the impairment loss will be recognised in the statement of comprehensive income. Insurance payables are initially recognised at fair value and subsequently held at amortised cost.

Insurance and intermediaries payables	£m
Due to policy holders	18
Due to intermediaries	1
Total insurance and intermediaries payables - IFRS	19
Reclassification from technical provisions to insurance and intermediaries payables	45
Total insurance and intermediaries payables -solvency valuation	64

The maturity profile of the liability recognised in the financial statements is summarised in the following table:

						£m
	Within 1 year	1 - 3 years	3 - 5 years	Over 5 years	UL	Total
Insurance and intermediaries payables	19	-	-	-	-	19

2. Payables (trade, not insurance)

For solvency valuation purposes, debts owed to credit institutions are valued consistently with IFRS.

Under IFRS, reinsurance payables are recognised when due. Where there is objective evidence that the carrying value is impaired then the impairment loss will be recognised in the statement of comprehensive income. Reinsurance payables are initially recognised at fair value and subsequently held at amortised cost.

Payables (trade, not insurance)	£m
Bank overdrafts	9
Trade payables	27
Amounts owed to group undertakings	11
Other taxes and social security costs	12
Other payables	28
Accruals and deferred income	69
Total Payables (trade, not insurance) - IFRS	156
Reclassification of payables included in BEL calculations	(13)
Payables (trade, not insurance) -solvency valuation	143

The maturity profile of the liability recognised in the financial statements is summarised in the following table:

	Within 1 year	1 - 3 years	3 - 5 years	Over 5 years	UL	£m Total
Payables (trade, not insurance)	143	-	-	-	-	143

The financial liability is presented based on the undiscounted contractual obligations and as such will not agree with the balances disclosed within the Statement of Financial Position in the statutory financial statements.

3. Subordinated liabilities

In 2013 the Society issued £350m of Fixed Rate Reset Subordinated Notes at par. The effective interest rate on the Notes is 6.654%. The Notes have a maturity date of 22nd May 2043 but the Society has the option to redeem the Notes at the first call date of 22nd May 2023 and at five yearly intervals thereafter up to the maturity date.

Interest is payable on the Notes at a fixed rate of 6.5% per annum for the period until the first call date on 22nd May 2023, payable annually in arrears on 22nd May each year. If the Notes are not redeemed on 22nd May 2023, the interest rate is reset on that date and at five yearly intervals thereafter at a rate equal to the five year gilt rate quoted on the day before the reset date plus an initial margin of 463 basis points and a step up margin of 100 basis points. There is an option of cumulative deferral of interest at the issuer's discretion and mandatory interest deferral in the event that a regulatory deficiency interest deferral event has occurred or is continuing (breach of the applicable regulatory solvency capital requirement of the issuer or group) or would occur if payment of interest on the subordinated notes were to be made. Following any deferral of a principal or interest payment, the Society would be prevented from declaring any distribution to members which falls within the Mutual Bonus arrangements.

The Society has the option to elect to defer payment of interest in whole or in part and this will not constitute a default or give the right to the noteholders or the trustee to accelerate repayment of the Notes or to take any enforcement action.

The Subordinated Notes meets in full the requirements in Article 73 of the delegated acts and as such can be classed as Tier 2 Capital.

For solvency valuation purposes, the Notes are measured using the risk free rate at the valuation date, whilst keeping the spread versus risk free rate at point of issue constant, thus eliminating the effect of changes in credit rating. The model uses the discounted cashflow approach with the spread measured against the risk free rate to equate back to the amount of debt issued. It also allows for accrued interest at point of valuation. It is assumed that the first call date of 2023 is the maturity date.

Under IFRS, the Notes are initially measured at the fair value of the proceeds less attributable transaction costs. Subsequent to initial recognition they are measured at amortised cost. The transaction costs are amortised over the period to the earliest possible redemption date on an effective interest rate basis. The amortisation charge is included in the Statement of Comprehensive Income within finance costs. An equivalent amount is added to the carrying value of the liability such that at the redemption date the value of the liability equals the redemption value.

Subordinated liabilities	£m
Subordinated notes (GBP 350m)	347
Subordinated liabilities - IFRS	347
Revaluation of subordinated debt	26
Subordinated liabilities -solvency valuation	373

D.4 Alternative methods for valuation

Information is provided for assets valued using alternative methods.

Justification for using alternative methods

The Group aims to use quoted market prices or observable inputs to value all assets and liabilities however where there is no external market or readily observable inputs, the Group will use an alternative method such as discounted cash-flow or mark-to-model.

Assumptions used in valuation approach and areas of uncertainty

Alternative methods for valuation include the use of estimates and assumptions that are not market observable but are based on a combination of internally developed models, calibrated to market observable data where possible as well as independent third-party evidence. Valuation uncertainty arises where there is reliance on third-party adherence to expected valuation standards or potential variation in the expected range of the key inputs into models.

The following material assets have been valued using alternative valuation methods in accordance with Article 263 of the Delegated Acts:

- Equity release mortgages are the only financial instrument LVFS has which is significantly impacted by reasonably possible changes in unobservable inputs. The loans secured on residential property are sensitive to changes in discount rate spread, which includes the profit and liquidity premium. The impact of reasonably possible alternative assumptions is shown in table below;

Description	Unobservable input	2016		
		Reasonably possible alternative assumptions		
		Current fair value	Increase in fair value	Decrease in fair value
		£m	£m	£m
Loans secured on residential property	Discount rates	685	38	-35

For Equity release mortgages (£685m), please refer to Section D Assets Note 6 Loans and Mortgages, sub-heading Equity release mortgages for the valuation basis.

- Unlisted equity (£174m) being private equity holdings are valued at net asset value using unobservable external prices factoring in distributions or calls since the latest valuations. The private equity valuations are reviewed on a monthly basis by LVFS Group Treasury to ensure ongoing validity and accuracy.
- Property (£5m) is valued in accordance with the RICS Appraisal and Valuation Standards by professional, third party, independent chartered surveyors Eddisons Commercial Ltd. The valuation is on an income approach basis and requires the use of observable inputs for rental income and yield assumptions which take into account comparable properties.
- Property, plant and equipment (£9m) is valued at fair value which that the IFRS carrying value, based on amortised cost, to be materially the same as fair value.

E. Capital Management (LVFS - Solo)

E.1 Own funds

The key capital management policies and objectives for LVFS are set at Group level and consistent across all entities. The approach to measuring and monitoring capital for LVFS is defined and actioned at Group. In addition the Group backs all the underlying entities has in place mechanisms to support all underlying entities capital positions.

For further information on these please see section E.1a and E1b of the Group section of this report.

The following table details the structure, amount and quality of basic own funds.

	Tier 1 £m	Tier 2 £m	Tier 3 £m	Total £m
Surplus funds	1,116	-	-	1,116
Reconciliation reserve	(89)	-	-	(89)
Subordinated liabilities	-	373	-	373
Total Basic Own Funds	1,027	373	-	1,400
Deductions from Own funds				
Total deductions from Own funds	-	-	-	-
Total available Own Funds to meet the SCR	1,027	373	-	1,400
Total available Own Funds to meet the MCR	1,027	373	-	1,400

The following tables detail the eligibility of own funds to meet the SCR and MCR.

Total available Own Funds to meet the SCR	1,027	373	-	1,400
Tier 2 capital restriction	-	(35)	-	(35)
Total eligible Own Funds to meet the SCR	1,027	338	-	1,365
Total available Own Funds to meet the MCR	1,027	373	-	1,400
Tier 2 capital restriction	-	(339)	-	(339)
Total eligible Own Funds to meet the SCR	1,027	34	-	1,061

As a mutual LVFS does not have any shareholders.

There are no terms and conditions attached to the Tier 1 Own Funds which for LVFS comprise of the following;

- Surplus Funds
- Reconciliation reserve

Tier 2 consists of subordinated debt of £350m, issued by LVFS in May 2013 and has an original maturity date of May 2043 and the first opportunity to redeem the loan notes occurs on 22 May 2023. It meets the qualifying criteria to be classed as Tier 2 own funds. Eligible Own Funds is £35m lower than the Basic Own Funds shown above due to the restrictions on Tier 2 subordinated debt.

For more information on the terms and conditions of Tier 2 subordinated liabilities can be found in Section D1, Other Liabilities Note 5.

LVFS has no Tier 3 own funds

Surplus Funds

Surplus funds are similar to the unallocated divisible surplus of the Society as reported under IFRS, inasmuch as it represents the excess of assets over technical provisions and other liabilities. It represents amounts that have yet to be formally declared as bonuses for the participating policy holders together with the free assets of the Group. Any profit of loss for the year is transferred to the surplus funds account.

UK regulations, the Society's Principles and Practices of Financial Management, and the terms and conditions of participating contracts set out the bases for the determination of the amounts on which the participating additional discretionary contracts benefits are based and within which the Society may exercise its discretion as to the quantum and timing of their payment to contract holders.

Reconciliation reserve

This reduces the tier 1 capital and represents surplus funds within ring fenced funds which are not available to the Society.

Subordinated liabilities

Details of the subordinated liabilities along with their payment schedule are explained in Section D3.

There is an option of cumulative deferral of interest at the issuer's discretion and mandatory interest deferral in the event that a regulatory deficiency interest deferral event has occurred or is continuing (breach of the applicable regulatory solvency capital requirement of the issuer or group) or would occur if payment of interest on the subordinated notes were to be made. Following any deferral of a principal or interest payment, the Society would be prevented from declaring any distribution to members which falls within the Mutual Bonus arrangements.

The Society has the option to elect to defer payment of interest in whole or in part and this will not constitute a default or give the right to the noteholders or the trustee to accelerate repayment of the Notes or to take any enforcement action.

Eligibility

For the SCR test the sum of the eligible amounts of Tier 2 and Tier 3 items shall not exceed 50 % of the SCR, The SCR is £676m which therefore means a maximum of £338m of subordinated debt is eligible to meet the MCR.

For the MCR test, the eligible amounts of Tier 3 and Tier 2 own funds shall not exceed 20 % of the MCR. The MCR is £169m which therefore means a maximum of £34m of subordinated debt is eligible to meet the MCR.

Analysis of significant changes in own funds during the reporting period

	LVFS		
	Day 1 2016 £m	Movement £m	Annual 2016 £m
Eligible own funds			
Tier 1 capital	933	94	1,027
Tier 2 capital	361	12	373
Total capital	1,294	106	1,400
Made up by:			
Surplus funds	1,002	114	1,116
Reconciliation reserve	-69	-20	-89
Subordinated liabilities	361	12	373
Total capital	1,294	106	1,400
Total eligible own funds to meet SCR	1,294	106	1,400

- Tier 1 capital includes movements in excess of assets over liabilities, adjusted for the movement in the reconciliation reserve.
- Tier 2 capital represents the subordinated debt.
- Surplus funds have increased due to the Solvency II profit generated during the year.
- The reconciliation reserve comprises of adjustments (e.g. Ring Fenced Funds, Deferred tax etc.) to the capital elements used in the calculation of SCR

Ancillary own funds

At 31st December 2016 there are no ancillary own funds.

Deductions from own funds

At 31st December 2016 there are no deductions from own funds

Explanation of the key elements of the reconciliation reserve

Reconciliation reserve	£m
Adjustment for restricted own fund items in respect of ring fenced funds	89
Total	89

The adjustment for ring fenced fund items includes 2 ring fenced funds operated by the Society.

Material differences between equity as shown in the undertaking's financial statements and the excess of assets over liabilities as calculated for solvency purposes

LVFS is a friendly society and is incorporated under the Friendly Societies Act 1992. As a mutual insurer we are owned by our members and not by any shareholders. Unallocated divisible surplus represents the excess of assets over and above the long-term insurance contract liabilities and other liabilities. It represents amounts that have yet to be formally declared as bonuses for the participating contract policyholders together with the free assets of the Society. Any profit or loss for the year arising through the Statement of Comprehensive Income is transferred to or from the unallocated divisible surplus. The following table provides a reconciliation of equity (unallocated divisible surplus) under IFRS to Solvency II excess of assets over liabilities.

	At 31st December 2016
	£m
Analysis of Equity per the statutory financial statements	
Ordinary shares, allotted and fully paid	-
Unallocated divisible surplus	1,019
Retained Earnings	-
Total Equity - IFRS	1,019
Solvency II Adjustments (excluding reclassifications)	
<u>Assets</u>	
- Reduction in valuation of participations (Section D1 note 1)	(385)
- Reduction in valuation of intangibles	(11)
- Reduction in valuation of reinsurance recoverable (Section D1 note 5)	(490)
	(886)
<u>Technical provisions</u>	
- Decrease in valuation of technical provisions (Section D2)	1039
<u>Other liabilities</u>	
- Increase in payables	(32)
- Increase in subordinated debt	(26)
- Other	2
	(56)
Total Equity - solvency valuation	1,116
Restricted own fund items due to ring fencing	(89)
Subordinated liabilities allowable as own funds items	373
Total own funds - solvency valuation	1,400
Excess of Assets over Liabilities - solvency valuation	
Total Assets	13,437
Total Technical Provisions	(11,300)
Total Other Liabilities	(1,021)
Excess of Assets over Liabilities solvency valuation	1,116

As detailed in the table above, numerous Solvency II adjustments were made to the balance sheet values as reported in the statutory financial statements. The adjustments arose from different valuation rules under Solvency II compared to the statutory financial statements.

Under Solvency II requirements, subordinated liabilities are included as a reconciling item in the table above since they are treated as liabilities for IFRS but count towards own funds.

Own-fund item that is subject to the transitional arrangements

There are no own fund items subject to transitional arrangements for LVFS.

E.2 SCR and MCR

E.2.1 LVFS SCR and MCR

The SCR for LVFS as at 31st December 2016 was £676m. The SCR increased over the reporting period largely due to the reduction in interest rates over the year and new business, partially offset by the implementation of the matching adjustment and capital optimisation activities.

The approach adopted for calculation of the SCR is the same as that described in the Group section, with the exception of the valuation of subsidiaries. On a Group basis subsidiaries are valued on a look through basis, with their risks added to that of the parent. On a Solo basis subsidiaries are instead valued as debt or equity holdings, essentially treating them in a similar way to investments made outside the Group.

The Minimum Capital Requirement (MCR) as at 31st December 2016 was £169m. The calculation of the MCR is laid out in the S.28.01.01 QRT included with this report. The MCR is determined using a calculation, as specified in the Solvency II regulations, involving the technical provision, capital at risk and SCR, subject to a floor specified in Euros and converted to pounds sterling. For LVFS the biting requirement is 25% of the SCR. The reason for the increase in the MCR over the year is the increase in SCR.

E.2.2 Group SCR split by risk

The Society uses a Standard Formula approach for calculating its regulatory SCR, although it maintains its own internal view of capital. The following table shows the breakdown of the SCR by risk on the Standard Formula basis. In line with the construction of the Standard Formula SCR, the amounts for each risk module contain some diversification allowance within that module. For example the market risk line includes diversification between equity and interest rate risk. The individual modules also include an allowance for the loss absorbing capacity of technical provisions.

The below figures allow for the structure of the Society, and specifically RNPFN and Teachers Ring Fenced Funds contained within LVFS. The capital requirements for these funds are calculated in isolation and added to those of LVFS, with no credit being taken for diversification between them.

Risk Module	£m
Market risk	497
Credit counterparty risk	22
Life underwriting risk	252
Health underwriting risk	86
Total before diversification	857
Diversification	(174)
Basic Solvency Capital Requirement	683
Operational risk	50
Loss absorbing capacity of deferred taxes	(56)
Other adjustments	0
Solvency Capital Requirement	676

E.2.3 Diversification benefit

See Group section E.2.3

E.2.4 Basis of calculation

The Society uses a Standard Formula basis to calculate the SCR. The approach to calculating the SCR and MCR is in accordance with the Solvency II Directive. The Society is not using any material simplifications or undertaking specific parameters in the calculation of the SCR and does not have any regulatory capital add-ons.

E.3 Use of a duration-based equity risk sub-module

The Society has not applied the duration-based equity risk sub-module in the calculation of the SCR.

E.4 Differences between Standard Formula and any Internal Model used

This does not apply as the Society does not use an Internal Model to calculate its SCR.

E.5 Non-compliance with the MCR and the SCR

The Society has been compliant with the MCR and SCR throughout the reporting period.

E.6 Any other material information

There is a significant overlap between the LVFS Group and Solo calculations and the approach used for LVFS Solo is the same as used for the Group. Therefore further details can be found in the Group part of this report.

LVLC SFCR

A. Business and Performance (LVLC)

A.1 Business

a) Name and legal form of undertaking

Liverpool Victoria Life Company Limited is a UK-incorporated and domiciled company limited by shares.

For the contact details of LVLC please see part a) in chapter A1 of the Group section of this report.

b) Name and contact detail of the supervisory authority responsible for financial supervision.

Firm's reference number: 110423

The Prudential Regulation Authority is responsible for the financial supervision of the company.

For the contact details of the PRA please see part b) in chapter A1 of the Group section of this report.

c) Name and contact details of the external auditor

The independent auditors are PricewaterhouseCoopers LLP

Address: 3 Forbury Place

23 Forbury Road

Reading

Berkshire

RG1 3JH

d) Description of the holders of qualifying holdings in the undertaking

For a description of 'qualifying holdings' please see part d) in chapter A1 of the Group section of this report.

LVLC is a wholly owned subsidiary of LVFS.

e) Details of the undertakings within the group

For an explanation of the undertakings position within the group please see part e) in chapter A1 of the Group section of this report.

f) Material lines of business and material geographic areas.

Materially LVLC underwrites life insurance contracts within the UK.

Life:

The principal activity is the provision of protection and retirement solution products. The core products offered in protection are Life, Critical Illness, Income Protection and Unemployment Insurance while the core products offered in retirement solutions are Annuities, Self-Invested Personal Pensions (SIPPs), Equity Release Mortgages and Flexible Guarantee Bonds.

As such the following Solvency II life lines of business are written:

- Other life insurance
- Health reinsurance
- Life reinsurance

g) Significant business or other events occurring during the reporting period that have a material impact on the undertaking.

LVLC's main purpose during the year was to manage the run-off of the UIA (Insurance) Limited business acquired in 2005 which relates to 98% of the insurance contract liabilities reported. LVLC is also the reinsurer of Protection contracts consisting of term assurances and critical illness policies for which it receives premium income.

2016 witnessed some significant events, including the UK vote to leave the EU and the outcome of the US presidential election, which caused increased political uncertainty, and associated focus on other types of risk e.g. financial market instability and currency movements. However, given the nature of LVLC's business, these events had minimal impact on its risk profile.

There were two changes of Director during 2016:

M J Rogers - Resigned 28 July 2016	M Rix - Appointed 24 March 2016
------------------------------------	---------------------------------

Apart from the director changes, the governance of LVLC remained stable, and apart from the impact of the change in solvency regulations at the start of the year, the solvency position and overall strength of the business was consistent.

LVLC used the Standard Formula to calculate its capital requirements throughout 2016, and this is expected going forward.

LV= has regulatory approval for the submission of a Group ORSA report. This means that the outputs of the individual ORSAs conducted for each of the Insurance Entities, in addition to those of the LV= Group, must be documented within the Group ORSA Report. There were no specific recommendations in the ORSA relating to LVLC.

A.2 Underwriting performance

All business is underwritten in the UK and given the nature of the business and the relatively small size of the business compared to other companies within the LV= Group, LVLC has not entered into any reinsurance treaties to transfer insurance risk to an external reinsurer.

The following tables provide information on the income and expenses analysed by material lines of business written during the current and prior reporting periods:

2016	Other life insurance	Health reinsurance	Life reinsurance	Total
	(£000)	(£000)	(£000)	(£000)
Net earned premiums	125	418	21	564
Net claims incurred including changes in other technical provisions	(1,215)	(266)	(75)	(1,556)
Expenses incurred (excluding investment management expenses)	(34)	(0)	(1)	(35)
Net total	(1,124)	152	(55)	(1,027)

2015	Other life insurance	Health reinsurance	Life reinsurance	Total
	(£000)	(£000)	(£000)	(£000)
Net earned premiums	166	400	29	595
Net claims incurred including changes in other technical provisions	80	(441)	(180)	(541)
Expenses incurred (excluding investment management expenses)	(40)	0	(2)	(42)
Net total	206	(41)	(153)	12

The income and expenses in the above tables are recognised on an IFRS basis but have been aligned to QRT S.05.01. Therefore claims management expenses are moved from net claims incurred to expenses incurred. Investment management expenses are removed from expenses incurred and included within investment performance.

In totality, net earned premiums and incurred expenses (excluding investment management expenses) remained relatively flat from 2015 to 2016 due to the run off nature of the UIA business. Claims payments were in line with reserve releases. As LVLC matched assets to liabilities then positive investment returns (as shown in A3 Investment Performance) increase the net claims due to changes in the BEL.

As there are some minor differences in the accounting treatments required under Solvency II versus the financial statements, the Solvency II data tables have been reconciled to the financial statements as follows:

	2016	2015
	(£000)	(£000)
Net earned premium per the financial statements	564	595
Net total per Solvency II	564	595
Net claims incurred per the financial statements	(1,556)	(541)
Operating expenses per the financial statements	(54)	(73)
Less investment management expenses	19	31
Net total per Solvency II	(35)	(42)

Given the nature of the business and the relatively small size of the business compared to other companies within the LV= Group, LVLC has not entered into any reinsurance treaties to transfer insurance risk to an external reinsurer.

A.3 Investment performance

The following table summarises the income and expenses with respect to investment activities during the last reporting period together with a comparison of the information with that reported on the previous reporting period:

LVLC	2016 (£000)	2015 (£000)
Dividend income	5	7
Interest income	501	615
Realised / unrealised gains/(losses)	1,253	(501)
Investment expenses	(19)	(31)
Total Investment Performance	1,740	90

The following table summarises the undertaking's overall investment performance during the reporting period and also by relevant asset class:

2016 Asset class (£000)	Dividends	Interest	Realised / Unrealised gains / losses	Total	Percentage of total	Average investment holding during 2016	Average investment return
Government bonds	-	488	1,236	1,724	98.0%	15,551	11.1%
Corporate bonds	-	9	17	26	1.5%	531	4.9%
Collective investment undertakings	5	-	-	5	0.3%	932	0.5%
Cash and deposits	-	4	-	4	0.2%	3,715	0.1%
Total	5	501	1,253	1,759			
Less investment expenses				(19)			
Net total				1,740			

2015 Asset class (£000)	Dividends	Interest	Realised / Unrealised gains / losses	Total	Percentage of total	Average investment holding during 2016	Average investment return
Government bonds		599	(494)	105	86.6%	15,978	0.7%
Corporate bonds		11	(7)	4	3.5%	343	1.2%
Collective investment undertakings	7			7	5.8%	416	1.7%
Cash and deposits		5		5	4.1%	9,756	0.1%
Total	7	615	(501)	121			
Less investment expenses				(31)			
Net total				90			

A.4 Performance of other activities

There are no other material income and expense items included for this organisation.

A.5 Any other information

There is no additional information to disclose for section A.

B. System of Governance (LVLC)

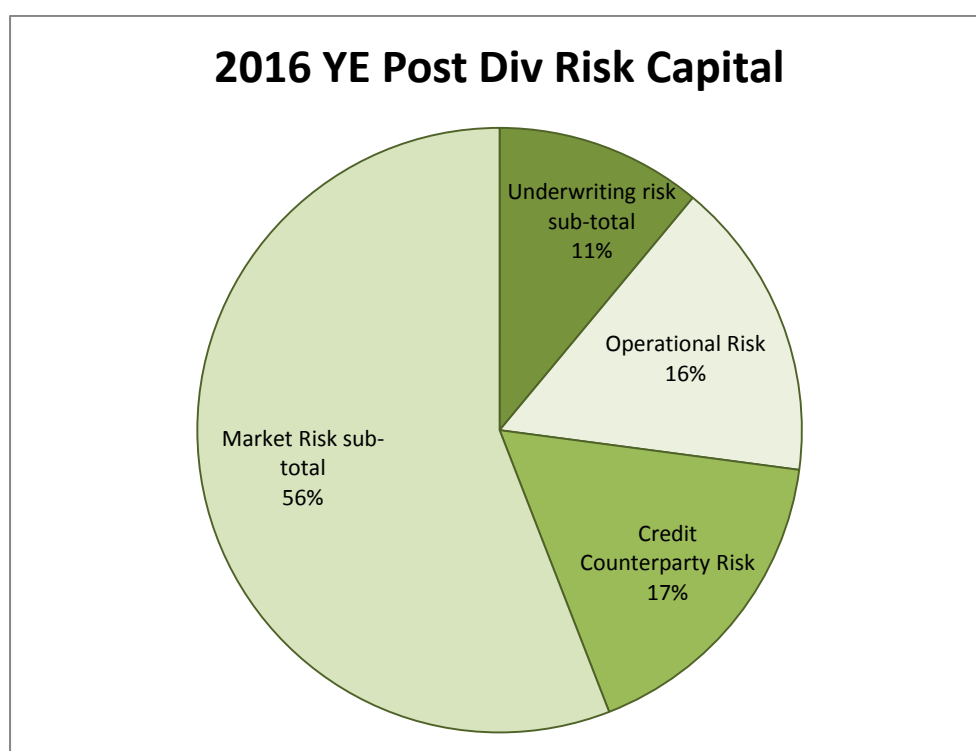
The system of governance for LVLC is described in Section B of the Group section of this report.

C. Risk Profile (LVLC)

C.1 Overview

C.1.1 Overview of risk exposures

The product range in LVLC principally covers a mixture of whole of life assurances, endowment assurances and term assurances acquired from UIA Ltd in 2005, in addition to accepting a small volume of reinsurance business from external organisations. The company does not cede any reinsurance to other parties and all lines are closed to new business. The main area of risk exposure is market risk. There is also some reasonable contribution to the SCR arising from Credit Counterparty Risk and Operational Risk. These are covered in more detail in the sections below. In addition, the contribution of these risks to the overall Solvency Capital Requirement (SCR) for LVLC is shown below. However, at December 2016, the SCR falls below the Absolute Minimum Capital Requirement (AMCR) that LVLC is required to hold. It is expected that this position is likely to continue going forward. The AMCR at December 2016 was £3.3m.



C.1.2 Measurement of risk exposures

A group wide approach is taken in measuring risk exposures. This is described within the main LVFS Group SFCR in section C1.2.

C.1.3 Prudent person principle

A common investment framework is employed across the LVFS Group and its subsidiaries. This is set out within the main LVFS Group SFCR in section C1.3.

C.1.4 Risk concentration

There are no material concentrations of risk within LVLC. As a result, the SCR at December 2016 falls below the minimum prescribed capital requirement (AMCR).

C.1.5 Risk mitigation techniques

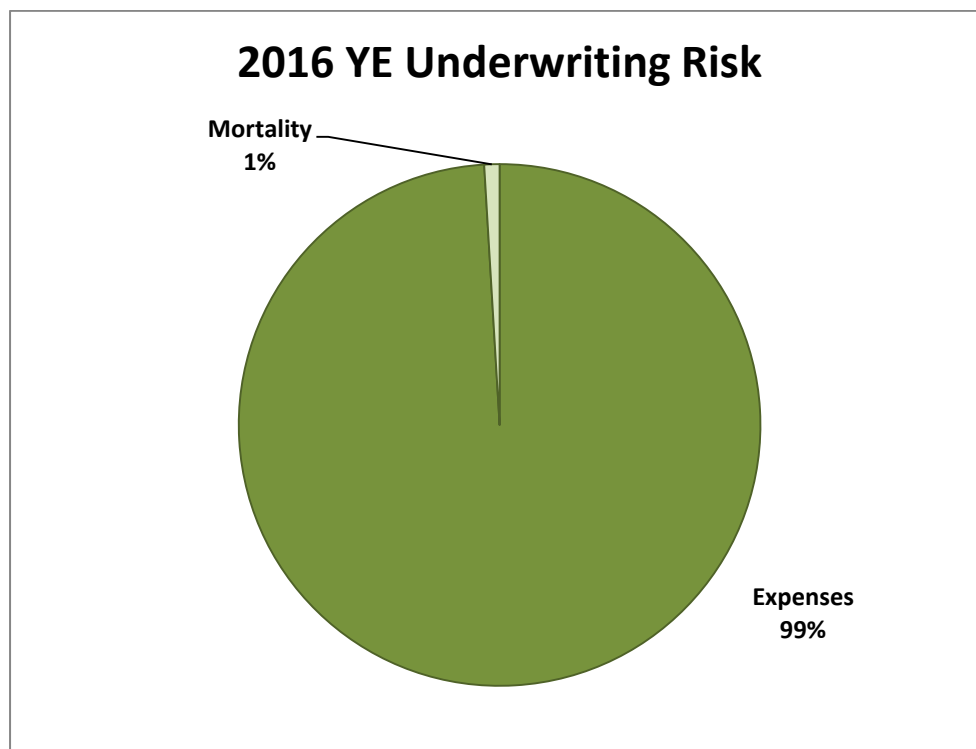
LVLC does not cede any business to either internal or external reinsurance parties, nor does it engage in any hedging strategies.

C.2 Underwriting risk

C.2.1 Underwriting risk exposure

LVLC is exposed to the following underwriting risks:

- Expense Risk – the risk that expenses are different to current best-estimate assumptions for example due to inflation or regulatory change.
- Mortality Risk – the risk that individuals die sooner than anticipated compared to under the best estimate assumptions, potentially causing an increase in liabilities.



These risks are managed through ongoing monitoring. However, they are not currently considered material.

C.2.2 Material changes over the reporting period

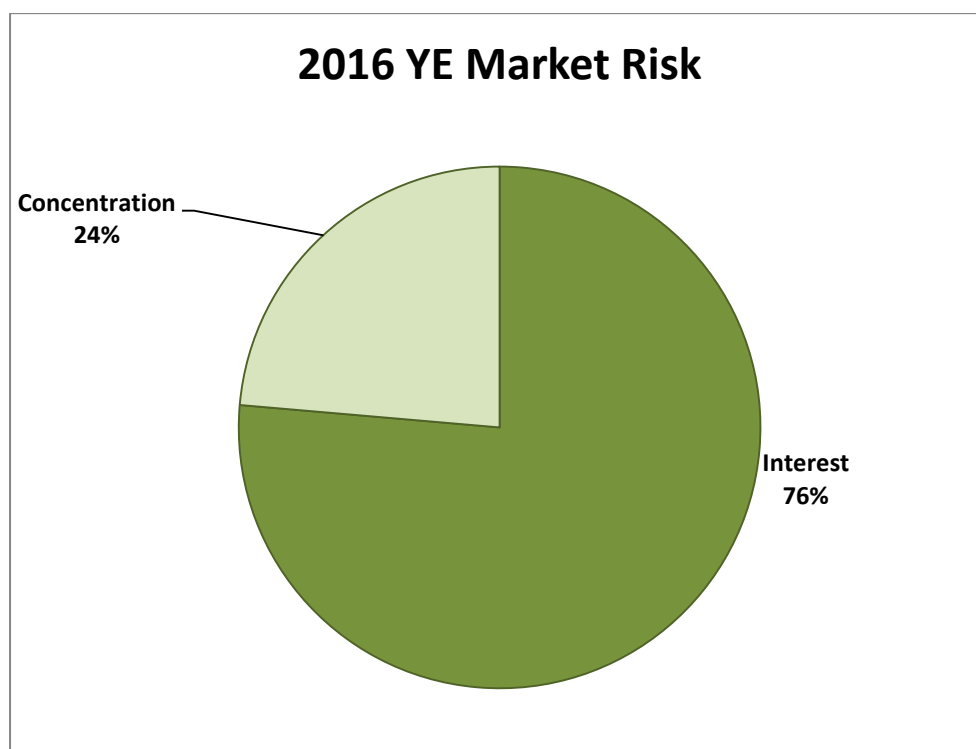
There have been no material changes in the level of underwriting risk during 2016.

C.3 Market risk

C.3.1 Market risk exposure

LVLC is exposed to the following market risks:

- Interest Rate Risk – this is present under all lines of business as the best-estimate liabilities are calculated by discounting future cashflows.
- Concentration Risk – the risk arising from a large exposure to various counterparties across different forms. It includes the build-up of risk exposure to any particular asset, issuer or group of undertakings, or geographical area and excessive accumulation of risk in the portfolio as a whole.



These risks are managed through aligning the investment strategy with the organisation's risk appetite and matching assets with liabilities as far as possible. These actions aim to match the risks arising from the liabilities with the risks inherent in the assets used to back them.

C.3.2 Material changes over the reporting period

There have been no material changes in the level of market risk during 2016.

C.4 Credit counterparty risk

C.4.1 Credit counterparty risk exposure

LVLC is exposed to the default of counterparties of investments, where money owed to LVLC cannot be recovered.

Credit Counterparty Risk concentrations are monitored across the Group, aggregating similar risks that arise in distinct Group entities where necessary, to ensure that unexpected sensitivities to risks are not allowed to build up.

Credit Counterparty risk is described further section C4 of the main LVFS Group SFCR.

C.4.2 Material changes over the reporting period

There have been no material changes in the level of credit counterparty risk during 2016.

C.5 Other material risks

Liquidity, operational and other risks are managed at a LVFS Group level and are described further in section C5, C6 and C7 of the LVFS Group SFCR.

C.6 Sensitivities

No stress and scenario testing is conducted for LVLC because of the limited risk exposures within the company. In addition, the absolute minimum capital requirement applies and is expected to continue to apply going forward.

D. Valuation for Solvency Purposes (LVLC)

D.1 Assets

For solvency valuation purposes, assets and liabilities are valued consistently with IFRS provided that IFRS valuation methods are consistent with Article 75 of Directive 2009/138. Asset and liability values represent the fair value amount for which they could be exchanged between knowledgeable willing parties in an arm's length transaction.

The financial statements of the undertaking have been prepared in accordance with:

- IFRS, as endorsed by the European Union ('EU').
- International Financial Reporting Interpretations Committee ('IFRIC').
- Statement of Recommended Practice issued by the Association of British Insurers (2005), amended 2006.
- those parts of the Companies Act 2006 applicable to companies reporting under IFRS.

	Note	2016		
		IFRS	Adjustments	Solvency
Assets		£k	£k	£k
Investments (other than assets held for index-linked and unit-linked contracts)	1	16,875	2,107	18,982
Bonds		15,523	1,086	16,609
Collective Investments Undertakings		1,352	-	1,352
Deposits other than cash equivalents		-	1,021	1,021
Cash and cash equivalents	2	3,937	-2,021	1,916
Any other assets, not elsewhere shown	#	118	-52	66
Total assets		20,930	34	20,964

#= Disclosure note not provided as solvency value equal to IFRS or the amounts are immaterial.

Supporting Notes

1. Investments

For Solvency II valuation purposes, financial assets are valued consistently with IFRS. However there are also there are mapping differences between the IFRS and Solvency II hierarchies which certain assets such as Collective Investment Undertakings are presented differently under IFRS.

Under IFRS, financial assets are valued at fair value through income which has two sub categories:

- Financial assets held for trading; and
- Those designated at fair value through income at inception.

Financial assets designated at fair value through income at inception are measured at market prices, or prices consistent with market ratings should no price be available. Day one gains are recognised only where valuations use data from observable markets. Any unrealised or realised gains or losses are taken to the Statement of Comprehensive Income, as fair value gains or losses, or realised gains or losses respectively, as they occur.

Financial assets at fair value through income; further information is provided in the table below.

Fair value estimation

For Solvency II valuation purposes, the fair value measurement hierarchy is as follows:

- Quoted market prices in active markets for same assets and liabilities (QMP). This is the default valuation method and is broadly consistent with Level 1 category assets under IFRS.
- Quoted market price in active markets for similar assets (QMPS). Maximum use is made of relevant market inputs such as quoted prices for identical or similar assets in an inactive market, observable inputs other than quoted prices and market corroborated inputs derived from observable market data. This is broadly consistent with Level 2 category assets under IFRS.
- Other alternative valuation method (AVM). Unobservable inputs reflecting the assumptions market participants would use when pricing the asset or liability, including assumptions about the risk inherent in both the inputs and the valuation technique. The undertaking uses various valuation approaches, including market, income and cost approaches. This is broadly consistent with Level 3 category assets under IFRS.
- Adjusted Equity Method (AEM) for Participations

The following table presents the financial assets measured at fair value at 31st December 2016.

	QMP	QMPS	AVM	AEM	Total
	£k	£k	£k	£k	£k
Government bonds	15,579	-	-	-	15,579
Corporate bonds	1,000	30	-	-	1,030
Collective Investments Undertakings	1,352	-	-	-	1,352
Deposits other than cash equivalents	1,021	-	-	-	1,021
Investments (other than assets held for index-linked and unit-linked funds)	18,952	30	-	-	18,982

2. Cash and cash equivalents

For solvency valuation purposes, cash is valued consistently with IFRS with a reclassification adjustment for short term bank deposits which are included in investments (other than assets held for index-linked and unit-linked funds) as deposits other than cash equivalents due to the CIC code assigned to them.

Under IFRS, cash and cash equivalents comprise cash at bank and in hand, and short-term deposits with an original maturity of three months or less. These are valued at fair value based on amounts receivable on demand.

Cash and cash equivalents	£k
Bank Balances	1,916
Short term bank deposits	2,021
Total cash and cash equivalents - IFRS	3,937
Reclassify short term deposits into bonds	(1000)
Reclassify short term deposits into deposits other than cash equivalents	(1,021)
Total cash and cash equivalents -solvency valuation	1,916

D.2 Technical provisions

D.2.1 Technical provisions by line of business

The following table sets out the LVLC technical provisions split by Solvency II lines of business as at 31st December 2016.

Line of Business	31 st December 2016 - £000s		
	Best Estimate Liability (BEL)	Risk Margin (RM)	Total Solvency II Technical Provisions
Health insurance	28	0	28
Other life insurance	15,340	65	15,405
Total Life insurance obligations	15,368	65	15,433

D.2.2 Technical provisions methodology and assumptions

A description of the bases, methods and assumptions used for valuation of the technical provisions is set out in the following sections.

D.2.2.1 Technical provisions methodology and assumptions

Technical provisions have been calculated as the sum of the Best Estimate Liabilities (BEL) and Risk Margin. The Transitional Measure on Technical Provisions is not used in LVLC.

BEL

For all business, the BEL is the probability weighted average of future cashflows required to fulfil obligations to policyholders under existing contracts taking account of the time value of money using the relevant risk-free interest rate term structure. There is no reinsurance ceded by LVLC to either internal or external reinsurers, so all cashflows are calculated gross.

Risk Margin

Given its low level of materiality, the Risk Margin has been approximated. Appropriate allowance has been made in the calculation for the SCR, the average duration of the liabilities and the cost of capital.

Discount Rates

The basic risk free interest rate structure as published by EIOPA was used. No transitional adjustment, Matching Adjustment or Volatility Adjustment was made to the discount rate.

Tax

All products are classified as Basic Life Assurance and General Annuity Business (BLAGAB).

Inflation

The assumed inflation measure was the Retail Price Index (RPI). A single assumption was derived from market yields on long-term conventional and index-linked gilts.

Mortality

A standard population mortality table is used to reflect the mortality risk for all business within LVLC, with no adjustment.

Persistency

It is assumed that all policyholders retain their policies until maturity/expiry or earlier death.

Expenses

All expense cashflows expected to be incurred in servicing liabilities relating to existing contracts over their future lifetime were taken into account in determining the best estimate liability.

Investment Expenses

Investment expenses are modelled through an adjustment to the discount rate.

There have been no material changes in assumptions over the reporting period other than updating for economic conditions.

The calculation of the Technical Provisions is based on data, assumptions and models, which may not reflect actual future experience. In addition some simplifications are used where appropriate. As such a level of uncertainty is associated with these results.

D.2.3 Comparison of Solvency II and IFRS technical provisions

The table below shows the difference between the technical provisions under Solvency II and IFRS.

Technical Provisions	31 st December 2016 - £000s		
	Solvency II Value	IFRS Value	Difference
Health insurance	28	28	0
Other life insurance	15,405	15,254	151
Total Life insurance obligations	15,433	15,282	151

As at 31/12/2016, the main differences between the Technical Provisions shown on an IFRS basis and those on a Solvency II basis are that:

- Under Solvency II a risk margin is added to the liabilities
- The discount factor used to discount future cashflows is different under the two regimes. IFRS technical provisions are calculated using a flat discount factor based on gilt yields. Under Solvency II, a curve is used as prescribed by EIOPA and derived from swap rates. As at 31/12/2016, the swap rates were below gilt rates for later durations. Although the impact of this varies with the duration of different lines of business, overall the result is an increase in technical provisions under Solvency II relative to IFRS.

D.3 Other liabilities

For solvency valuation purposes, assets and liabilities are valued consistently with IFRS provided that IFRS valuation methods are consistent with Article 75 of Directive 2009/138. Assets and liabilities represent the fair value amount for which they could be exchanged between knowledgeable willing parties in an arm's length transaction.

The financial statements of the undertaking have been prepared in accordance with:

- IFRS, as endorsed by the European Union ('EU').
- International Financial Reporting Interpretations Committee ('IFRIC').
- Statement of Recommended Practice issued by the Association of British Insurers (2005), amended 2006 and;
- those parts of the Companies Act 2006 applicable to companies reporting under IFRS.

	Note	2016		
		IFRS	Adjustments	Solvency
Other Liabilities		£k	£k	£k
Insurance & intermediaries payables	1	1	274	275
Payables (trade, not insurance)	#	107	-	107
Any other liabilities, not elsewhere shown	#	31	35	66
Total other liabilities		139	309	448

#= Disclosure note not provided as solvency value equal to IFRS or the amounts are immaterial.

Supporting Notes

1. Insurance and intermediaries payables

For solvency valuation purposes, debts owed to credit institutions are valued consistently with IFRS. However there are presentational differences where under IFRS the Life Claims outstanding are disclosed as part of the technical provisions and for solvency purposes are reclassified to technical provisions.

Under IFRS, Insurance payables are recognised when due and include amounts due to policyholders, agents, brokers and intermediaries. Where there is objective evidence that the carrying value is impaired then the impairment loss will be recognised in the statement of comprehensive income. Insurance payables are initially recognised at fair value and subsequently held at amortised cost.

The maturity profile of the liability recognised in the financial statements is summarised in the following table.

Insurance and intermediaries payables	£k
Due to policy holders	1
Total insurance and intermediaries payables - IFRS	1
Reclassification from technical provisions to insurance and intermediaries payables	274
Total insurance and intermediaries – solvency valuation	275

The maturity profile of the liability recognised in the financial statements is summarised in the following table:

	Within 1 year	1 - 3 years	3 - 5 years	Over 5 years	UL	£k
Insurance and intermediaries payables	1	-	-	-	-	1

D.4 Alternative methods for valuation

There are no material assets or liabilities for LVLC that use alternative valuation methods.

E. Capital Management (LVLC)

E.1 Own funds

The key capital management policies and objectives for LVLC are set at Group level and consistent across all entities. The approach to measuring and monitoring capital for LVLC is defined and actioned at Group level. In addition the Group backs all the underlying entities and has in place mechanisms to support these capital positions if necessary

For further information on these please see section E.1a and E.1b of the Group section of this report.

The following table details the structure, amount and quality of basic own funds and ancillary own funds.

	Tier 1 £000	Tier 2 £000	Tier 3 £000	Total £000
Ordinary share capital (gross of own shares)	100	-	-	100
Reconciliation reserve	4,983	-	-	4,983
Subordinated liabilities	-	-	-	-
Total Basic Own Funds	5,083	-	-	5,083
Total available Own Funds to meet the SCR	5,083	-	-	5,083
Total available Own Funds to meet the MCR	5,083	-	-	5,083

The following tables detail the eligibility of own funds to meet the SCR and MCR.

Total available Own Funds to meet the SCR	5,083	-	-	5,083
Capital restrictions	-	-	-	-
Total eligible Own Funds to meet the SCR	5,083	-	-	5,083

Total available Own Funds to meet the MCR	5,083	-	-	5,083
Capital restrictions	-	-	-	-
Total eligible Own Funds to meet the SCR	5,083	-	-	5,083

No own funds has been reported for the prior year as allowed by article 303 of the Delegated Regulations

The basic own funds structure for LVLC is a combination of ordinary share capital and the reconciliation reserve which are both classified as Tier 1.

Changes in own funds during the reporting period

LVLC is a wholly-owned subsidiary of LVFS.

	LVLC		
	Day 1 2016 £0	Movement £0	Annual 2016 £0
Eligible own funds			
Tier 1 capital	5,075	8	5,083
Total capital	5,075	8	5,083
Made up by:			
Equity shares	100	-	100
Reconciliation reserve / surplus	4,975	8	4,983
Total capital	5,075	8	5,083
Total eligible own funds to meet SCR	5,075	8	5,083

- Tier 1 capital includes movements in excess of assets over liabilities.

Ancillary own funds

At 31st December 2016 there are no ancillary own funds.

Deductions from own funds

At 31st December 2016 there are no deductions from own funds

Explanation of the key elements of the reconciliation reserve

Reconciliation reserve	£000
Retained earnings on a Solvency II basis	4,983
Total	4,983

Material differences between equity as shown in the undertaking's financial statements and the excess of assets over liabilities as calculated for solvency purposes

The following table provides a reconciliation of equity under IFRS to Solvency II excess of assets over liabilities.

	At 31st December 2016
	£000
Analysis of Equity - IFRS	
Ordinary shares, allotted and fully paid	100
Retained Earnings	5,135
Total Equity - IFRS	5,235
Solvency II Adjustments (excluding reclassifications)	
<u>Assets</u>	
- Other	-
<u>Technical provisions</u>	
- Decrease in valuation of technical provisions (Section D2)	122
<u>Other liabilities</u>	
- Increase in payables	(274)
	(274)
Total Equity - solvency basis	5,083
Restricted own fund items due to ring fencing	-
Restricted own fund items due to subordinated liabilities	-
Total own funds - solvency basis	5,083
Excess of Assets over Liabilities - solvency basis	
Total Assets	20,964
Total Technical Provisions	(15,433)
Total Other Liabilities	(448)
Excess of Assets over Liabilities - solvency basis	5,083

As detailed in the table above, numerous solvency adjustments were made to the balance sheet values as reported in the statutory financial statements. The adjustments arose from different valuation rules under Solvency II compared to the statutory financial statements.

Under the Solvency II requirements, subordinated liabilities are included as a reconciling item in the table above since they are treated as liabilities for IFRS but count towards own funds.

Own-fund item that is subject to the transitional arrangements

LVLC has no own fund items subject to transitional relief.

E.2 SCR and MCR

E.2.1 SCR and MCR

The following table shows the amount of the SCR and MCR for LVLC:

	£000
Solvency Capital Requirement (SCR)	431
Minimum Capital Requirement (MCR)	3,332

There has been no material change in the SCR during 2016.

The calculation of the MCR is laid out in the S.28.01.01 QRT included with this report. The MCR is determined using a calculation, as specified in the Solvency II regulations, involving the technical provision, capital at risk and SCR, subject to a floor specified in Euros and converted to pounds sterling. For LVLC the biting requirement is the Absolute floor of the MCR, set equal to €3.7m Euros and converted to pounds sterling. There has been an increase in the Absolute Minimum Capital Requirement during 2016 of £700k due to a change in the Euro/Pound exchange rate over the period.

E.2.2 SCR split by risk

The following table summarises that risk modules which contribute to the Solvency Capital Requirement for LVLC applicable under standard formula.

Year-end 2016 - all figures in £000s

Category	Specific Risk	Post Diversified Capital Requirement
Credit Counterparty Risk		73
Market Risk	Interest	184
	Concentration	57
Market risk sub-total		241
	Expenses	48
	Catastrophe	0
Underwriting risk sub-total		48
Liquidity Risk		0
Operational Risk		69
SCR		431

E.2.3 Diversification benefit

See Group section E.2.2

E.2.4 Basis of calculation

LVLC uses a Standard Formula basis to calculate the SCR. The approach to calculating the SCR and MCR is in accordance with the Solvency II Directive. LVLC is not using any material simplifications or undertaking specific parameters in the calculation of the SCR and does not have any regulatory capital add-ons.

E.3 Use of a duration-based equity risk sub-module

LVLC has not applied the duration-based equity risk sub-module in the calculation of the SCR.

E.4 Differences between Standard Formula and any Internal Model used

This does not apply as LVLC does not use an Internal Model to derive its SCR.

E.5 Non-compliance with the MCR and the SCR

LVLC has maintained Own Funds in excess of the MCR (and hence the SCR) throughout the reporting period.

E.6 Any other information

There is no additional material information regarding capital management to disclose in this section.

LVPL Solo SFCR

A. Business and Performance (LVPL)

A.1 Business

a) Name and legal form of undertaking

Liverpool Victoria Protection Limited is a UK-incorporated and domiciled company limited by shares.

For the contact details of LVPL please see part a) in chapter A1 of the Group section of this report.

b) Name and contact detail of the supervisory authority responsible for financial supervision.

Firm's reference number: 611223

The Prudential Regulation Authority is responsible for the financial supervision of the company.

For the contact details of the PRA please see part b) in chapter A1 of the Group section of this report.

c) Name and contact details of the external auditor

The independent auditors are PricewaterhouseCoopers LLP

Address: 3 Forbury Place

23 Forbury Road

Reading

Berkshire

RG1 3JH

d) Description of the holders of qualifying holdings in the undertaking

For a description of 'qualifying holdings' please see part d) in chapter A1 of the Group section of this report..

LVPL is a wholly owned subsidiary of LVFS.

e) Details of the undertakings within the group

For an explanation of the undertakings position within the group please see part e) in chapter A1 of the Group section of this report.

f) Material lines of business and material geographic areas.

Materially LVPL underwrites non-life insurance contracts within the UK.

LVPL's main purpose during the year was to underwrite unemployment insurance as part of a combined policy by LVFS

As such the following Solvency II life lines of business are written:

- Miscellaneous financial loss insurance
-

g) Significant business or other events occurring during the reporting period that have a material impact on the undertaking.

2016 witnessed some significant events, including the UK vote to leave the EU and the outcome of the US presidential election, which caused increased political uncertainty, and associated focus on other types of risk e.g. financial market instability and currency movements. However, given the nature of LVPL's business, these events had minimal impact on its risk profile.

There were to changes of Director during 2016:

M J Rogers - Resigned 28 July 2016	M Rix - Appointed 24 March 2016
------------------------------------	---------------------------------

Apart from the director changes, the governance of LVPL remained stable, and apart from the impact of the change in solvency regulations at the start of the year, the solvency position and overall strength of the business was consistent.

LVPL used the Standard Formula to calculate its capital requirements throughout 2016, and this is expected going forward.

LV= has regulatory approval for the submission of a Group ORSA report. This means that the outputs of the individual ORSAs conducted for each of the Insurance Entities, in addition to those of the LV= Group, must be documented within the Group ORSA Report. There were no specific recommendations in the ORSA relating to LVPL.

A.2 Underwriting performance

All business is underwritten in the UK.

The following tables provide further information on the income and expenses analysed by material lines of business written during the reporting period:

2016	Miscellaneous financial loss	Other	Total
	(£000)	(£000)	(£000)
Net earned premiums	218		218
Net claims incurred including changes in other technical provisions	(211)		(211)
Expenses incurred (excluding investment management expenses)	(137)	(28)	(165)
Net total	(130)	(28)	(158)

2015	Miscellaneous financial loss	Other	Total
	(£000)	(£000)	(£000)
Net earned premiums	87		87
Net claims incurred including changes in other technical provisions	(5)		(5)
Expenses incurred (excluding investment management expenses)	(56)	(14)	(70)
Net total	26	(14)	12

The income and expenses in the above tables are recognised on an IFRS basis but have been aligned to QRT S.05.01. Therefore claims management expenses are moved from net claims incurred to expenses incurred. Investment management expenses are removed from expenses incurred and included within investment performance.

Overall, the net total has fallen by £170k from 2015 to 2016. Whilst net earned premiums have increased by £131k, unexpected adverse claims experiences resulted in net claims incurred rising by £206k. Furthermore, expenses incurred have increased by £95k over 2015 predominantly due to high acquisition expenses incurred for this type of product.

A.3 Investment performance

The following table summarises the income and expenses with respect to investment activities during the last reporting period together with a comparison of the information with that reported on the previous reporting period :

LVPL (£000)	2016	2015
Dividend income	17	19
Interest income	-	-
Net gains/(losses)	-	-
Unrealised gains/(losses)	-	-
Total Investment Performance	17	19

Other than a small cash balance (£10k), LVPL maintains an OEIC (Institutional Sterling Liquid Fund) with Blackrock of £3,448k). All investment income received relates to dividends paid by the OEIC. The slight fall from 2015 reflects the reduction in the OEIC due to the losses made.

The following table summarises the undertaking's overall investment performance during the reporting period and also by relevant asset class:

2016 Asset class (£000)	Dividends	Percentage of total	Average investment holding during 2016	Average investment return
Collective investment undertakings	17	100.0%	3,868.0	0.4%

The average investment holding listed above is a simplified average calculated as:
(investment holding at year end 2016 + investment holding at year end 2015) ÷ 2

2015 Asset class (£000)	Dividends	Percentage of total	Average investment holding during 2016	Average investment return
Collective investment undertakings	19	113.8%	2,144	0.9%

The average investment holding listed above is a simplified average calculated as:
(investment holding at year end 2016 + investment holding at year end 2015) ÷ 2

A.4 Performance of other activities

There are no other material income and expense items included for this organisation.

A.5 Any other information

There is no additional information to disclose for section A.

B. System of Governance (LVPL)

The system of governance for LVPL is described in Section B of the Group section of this report.

C. Risk Profile (LVPL)

C.1 Overview

C.1.1 Overview of risk exposures

LVPL only contains one product which provides short term payments to cover the risk of the policyholder being made involuntarily unemployed. The entity only contains business written since 1st January 2015. The volume of business and risk is low, with the absolute minimum capital requirement biting. By proportion, the key risks are underwriting and market risk.

C.1.2 Measurement of risk exposures

A group wide approach is taken in measuring risk exposures. This is described within the main LVFS Group SFCR in section C1.2.

C.1.3 Prudent person principle

A common investment framework is employed across the LVFS Group and its subsidiaries. This is set out within the main LVFS Group SFCR in section C1.3.

C.1.4 Risk concentration

Whilst there is only one product written in LVPL, concentration risk is mitigated through reinsurance as described in section C2 and the volume of business is small.

C.2 Underwriting risk

C.2.1 Underwriting risk exposure

The main underwriting risk exposure by proportion is premium risk, with lapse, catastrophe and reserve risk to a lesser extent, although the level of risk is low. The main uncertainty relates to the frequency and severity of future unemployment claims.

C.2.2 Material changes over the reporting period

The underwriting risks have increased by a small amount reflecting the increase in the volume of in-force business.

C.2.3 Risk mitigation techniques

Reinsurance is used as a risk mitigating technique to transfer unemployment risk outside of LVPL and the LVFS group. A common approach to monitoring the effectiveness of reinsurance is employed across the LVFS Group and its subsidiaries. This is set out within the main LVFS Group SFCR in section C2.3.

C.3 Market risk

C.3.1 Market risk exposure

Market risk is managed at the Group level and the specific risk exposures are described further in section C3.1 of the main LVFS Group SFCR.

Within LVPL, the main market risk exposure is concentration risk, as all assets are invested in a single investment fund. Whilst there is diversification within the fund, in the absence of detailed information on the underlying assets, concentration risk has been prudently calculated assuming this represents a single credit counterparty exposure.

C.3.2 Material changes over the reporting period

Concentration risk has fallen over the reporting period in proportion to the amount of the invested assets.

C.4 Credit counterparty risk

Credit Counterparty risk is described further in section C4 of the main LVFS Group SFCR. There is some exposure reinsurer and investment counterparties however this is not a material risk for LVPL.

C.5 Other material risks

Liquidity, operational and other risks are managed at a LVFS Group level and are described further in section C5, C6 and C7 of the LVFS Group SFCR. The expected profit in future premiums (EPIFP) for LVPL at year end was just over £0.5m.

C.6 Sensitivities

As the volume of business in LVPL is small, the materiality of sensitivities is low.

C.7 Additional information on risk profile

There is no relevant additional information.

D. Valuation for Solvency Purposes (LVPL)

D.1 Assets

For solvency valuation purposes, assets and liabilities are valued consistently with IFRS provided that IFRS valuation methods are consistent with Article 75 of Directive 2009/138. Asset and liability values represent the fair value amount for which they could be exchanged between knowledgeable willing parties in an arm's length transaction.

The financial statements of the undertaking have been prepared in accordance with:

- IFRS, as endorsed by the European Union ('EU').
- International Financial Reporting Interpretations Committee ('IFRIC').
- Statement of Recommended Practice issued by the Association of British Insurers (2005), amended 2006 and;
- Those parts of the Companies Act 2006 applicable to companies reporting under IFRS.

	Note	2016		
		IFRS	Adjustment	Solvency
Assets		£000	£000	£000
Deferred acquisition costs	1	627	(627)	-
Investments (other than assets held for index-linked and unit-linked contracts)		3,448	-	3,448
Collective Investments Undertakings	2	3,448	-	3,448
Reinsurance recoverables	3	406	(408)	-2
Insurance and intermediaries receivables	4	1,157	(1,157)	-
Reinsurance receivables	#	22	-	22
Receivables (trade, not insurance)	5	99	-	99
Cash and cash equivalents	#	10	-	10
Any other assets, not elsewhere shown	#	27	-	27
Total assets		5,796	(2,192)	3,604

#= Disclosure note not provided as solvency value equal to IFRS or the amounts are immaterial.

Supporting Notes

1. Deferred acquisition costs

For Solvency II valuation purposes, deferred acquisition costs are set to nil however the cashflows relating to DAC-able expenses, are included within the Technical Provisions valuation if they fall within the projected timeframes (see D2. Technical Provisions).

Under IFRS, the proportion of the costs of acquiring new general insurance business which relate to unearned premiums are deferred and recognised as an asset to the extent that they are recoverable out of margins in future matching revenues.

Acquisition costs comprise all allowable costs incurred in writing new contracts. Deferred acquisition costs are amortised over a period which is consistent with the assessment of the expected pattern of receipt of future revenue margins for each product type.

All deferred acquisition costs are tested for recoverability at each reporting date. The carrying values are adjusted to recoverable amounts and any resulting impairment losses are charged to the Statement of Comprehensive Income.

2. Investments

For solvency valuation purposes, financial assets are valued consistently with IFRS.

Under IFRS, financial assets are valued at fair value through income which has two sub categories:

- Financial assets held for trading; and
- Those designated at fair value through income at inception.

Financial assets designated at fair value through income at inception are measured at market prices, or prices consistent with market ratings should no price be available. Day one gains are recognised only where valuations use data from observable markets. Any unrealised or realised gains or losses are taken to the Statement of Comprehensive Income, as fair value gains or losses, or realised gains or losses respectively, as they occur.

Financial assets at fair value through income; further information is provided in the table below.

Fair value estimation

For Solvency II valuation purposes, the fair value measurement hierarchy is as follows:

- Quoted market prices in active markets for same assets and liabilities (QMP). This is the default valuation method and is broadly consistent with Level 1 category assets under IFRS.
- Quoted market price in active markets for similar assets (QMPS). Maximum use is made of relevant market inputs such as quoted prices for identical or similar assets in an inactive market, observable inputs other than quoted prices and market corroborated inputs derived from observable market data. This is broadly consistent with Level 2 category assets under IFRS.
- Other alternative valuation method (AVM). Unobservable inputs reflecting the assumptions market participants would use when pricing the asset or liability, including assumptions about the risk inherent in both the inputs and the valuation technique. The undertaking uses various valuation approaches, including market, income and cost approaches. This is broadly consistent with Level 3 category assets under IFRS.
- Adjusted Equity Method (AEM) for Participations

The following table presents the financial assets measured at fair value at 31st December 2016.

	QMP	QMPS	AVM	AEM	Total
	£k	£k	£k	£k	£k
Collective Investments Undertakings	3,448	-	-	-	3,448
Investments (other than assets held for index-linked and unit-linked funds)	3,448	-	-	-	3,448

3. Reinsurance recoverables

The undertaking cedes insurance risk in the normal course of businesses. Reinsurance assets represent balances recoverable from reinsurance companies.

For solvency valuation purposes, reinsurance recoverables are valued using the cash-flow projection method and in a consistent manner with the calculation of the best estimate liabilities (see D2. Technical provisions). Reinsurance recoverable is negative because the reinsurance premiums exceed the RI claims recoveries in the long term.

In calculating reinsurance recoverables under Solvency II, adjustments are made for the time difference between recoveries and direct payments and also for expected losses due to the default of a counterparty. The adjustment is based on an assessment of the probability of default of the counterparty and the average loss resulting therefrom (loss-given-default).

Under IFRS, recoverable amounts are estimated in a manner consistent with the outstanding claims provision. Reinsurance premiums are recognised in the same period as the underlying contract that they relate to.

	£k
Reinsurers' share of provision for unearned premiums	351
Reinsurers' share of claims liabilities	55
Total Reinsurance Recoverables - IFRS	406
Best estimate liability adjustments	(408)
Total reinsurance recoverables solvency valuation	(2)

4. Insurance and intermediaries receivables

For solvency valuation purposes, any future premiums (included in insurance receivables) which fall due after the valuation date and any premium debts (included within intermediaries receivables), are subject to best estimate liability calculation of technical provisions (see D2. Technical Provisions).

Under IFRS, insurance and intermediaries receivables are recognised when due and include amounts due from policy holders, agents, brokers and intermediaries. Insurance and intermediaries receivables are initially recognised at fair value and then subsequently held at amortised cost. Where there is objective evidence that the carrying value is impaired then the impairment loss will be recognised in the statement of comprehensive income.

Insurance and intermediaries receivables	£k
Due from policyholders	1,157
Due from agents, brokers and intermediaries	-
Total Insurance and intermediaries receivables - IFRS	1,157
Best estimate liability adjustments	(1,157)
Total reinsurance recoverables solvency valuation	-

5. Receivables (trade, not insurance)

For Solvency II valuation purposes, receivables are valued in conformity with IFRS.

Under IFRS, trade and other receivables are recognised when due. Trade and other receivables are initially recognised at fair value and then subsequently held at amortised cost. Where there is objective evidence that the carrying value is impaired then the impairment loss will be recognised in the statement of comprehensive income.

Receivables (trade, not insurance)	£000
Amount due from group undertakings	99
Total receivables (trade, not insurance) IFRS and solvency valuation	99

D.2 Technical provisions

D.2.1 Technical provisions by line of business

The following table sets out the LVPL technical provisions split by Solvency II lines of business as at 31st December 2016.

Line of Business	31 st December 2016 - £000s		
	Best Estimate Liability (BEL)	Risk Margin (RM)	Total Solvency II Technical Provisions
Other Non-Life	(526)	324	(202)
Total Non-Life insurance obligations	(526)	324	(202)

D.2.2 Technical provisions methodology and assumptions

Technical provisions have been calculated as the sum of the BEL and Risk Margin. The Transitional Measure on Technical Provisions is not used in LVPL.

BEL

The BEL corresponds to the probability weighted average of future cash flows taking account of the time value of money using the relevant risk-free interest rate term structure and allowing for contract boundaries, where relevant. The cash flows are projected gross, without deduction of the amounts recoverable from reinsurance contracts. Recoverables from reinsurance are calculated separately and are included as an asset on the balance sheet.

The BEL for LVPL is negative and reflects that the business written is profitable with the expected future income under the product being larger than the expected future claims.

Risk Margin

The Risk Margin is calculated by projecting the run-off of the pre-diversified SCR for each non-hedgeable risk, applying a correlation matrix to derive the projected run-off of the aggregate SCR, applying a cost of capital to this and discounting the costs back to the valuation date.

Discount Rates

The basic risk free interest rate structure as published by EIOPA was used. No transitional adjustment, MA or VA was made to the discount rate.

Inflation

The assumed inflation measure was the Retail Price Index (RPI). A single assumption was derived from market yields on long-term conventional and index-linked gilts.

Mortality

A standard population mortality table is used to reflect the mortality risk within LVPL.

Persistency

Persistency assumptions cover level and index-lined business with allowances for different commission clawback periods.

Expenses

The expense assumption is set in line with the service agreement.

D2.3 Comparison of Solvency II and IFRS technical provisions

The table below shows the difference between the technical provisions under Solvency II and IFRS.

Technical Provisions	31 st December 2016 - £000s		
	Solvency II Value	IFRS Value	Difference
Other Non-Life	(202)	1,237	(1,439)
Total Non-Life insurance obligations	(202)	1,237	(1,439)

As at 31st December 2016, the main difference between the technical provisions shown on an IFRS basis and those on a Solvency II basis is due to different calculation methodologies. The Solvency II technical provisions is made up of BEL and Risk Margin using a cash-flow projection approach, whilst the IFRS technical provisions is based on an unearned premium reserve calculation.

D.3 Other liabilities

For solvency valuation purposes, assets and liabilities are valued consistently with IFRS provided that IFRS valuation methods are consistent with Article 75 of Directive 2009/138. Assets and liabilities represent the fair value amount for which they could be exchanged between knowledgeable willing parties in an arm's length transaction.

The financial statements of the undertaking have been prepared in accordance with:

- IFRS, as endorsed by the European Union ('EU').
- International Financial Reporting Interpretations Committee ('IFRIC').
- Statement of Recommended Practice issued by the Association of British Insurers (2005), amended 2006 and;
- those parts of the Companies Act 2006 applicable to companies reporting under IFRS.

	Note	2016		
		IFRS £000	Adjustments £000	Solvency II £000
Other Liabilities				
Reinsurance payables	1	351	-351	-
Payables (trade, not insurance)	#	6	-	6
Total other liabilities		357	-351	6

#= Disclosure note not provided as solvency value equal to IFRS or the amounts are immaterial.

Supporting Notes

1. Reinsurance payables

For solvency valuation purposes, debts owed to credit institutions are valued consistently with IFRS.

Under IFRS, reinsurance payables are recognised when due. Where there is objective evidence that the carrying value is impaired then the impairment loss will be recognised in the statement of comprehensive income. Reinsurance payables are initially recognised at fair value and subsequently held at amortised cost.

Reinsurance payables	£k
Due to reinsurers	351
Total reinsurance payables - IFRS	351
Reinsurance payables included in BEL calculations	(351)
Total reinsurance payables solvency valuation	-

The maturity profile of the liability recognised in the financial statements is summarised in the following table:

						UL	Total
	Within 1 year	1 - 3 years	3 - 5 years	Over 5 years			£k
Insurance and intermediaries payables	351	-	-	-	-	-	351

D.4 Alternative methods for valuation

There are no material assets or other liabilities for LVPL that have had alternative valuation methods applied to them.

E. Capital Management (LVPL)

E.1 Own funds

The key capital management policies and objectives for LVPL are set at Group level and consistent across all entities. The approach to measuring and monitoring capital for LVPL is defined and actioned at Group level. In addition the Group backs all the underlying entities and has in place mechanisms to support these capital positions if necessary

For further information on these please see section E.1a and E.1b of the Group section of this report.

The following table details the structure, amount and quality of basic own funds and ancillary own funds.

	Tier 1 £000	Tier 2 £000	Tier 3 £000	Total £000
Ordinary share capital (gross of own shares)	1,000	-	-	1,000
Initial funds / members contributions	4,000	-	-	4,000
Reconciliation reserve	(1,200)	-	-	(1,200)
Subordinated liabilities	-	-	-	-
Total Basic Own Funds	3,800	-	-	3,800
Total available Own Funds to meet the SCR	3,800		-	3,800
Total available Own Funds to meet the MCR	3,800			3,800

The following tables detail the eligibility of own funds to meet the SCR and MCR.

Total available Own Funds to meet the SCR	3,800	-	-	3,800
Capital restrictions	-	-	-	-
Total eligible Own Funds to meet the SCR	3,800	-	-	3,800
Total available Own Funds to meet the MCR	3,800	-		3,800
Tier 2 capital restriction	-	-		-
Total eligible Own Funds to meet the SCR	3,800	-		3,800

No own funds has been reported for the prior year as allowed by article 303 of the Delegated Regulations

The basic own funds structure for LVPL is a combination of ordinary share capital, initial funds/members contributions and the reconciliation reserve which are all classified as Tier 1.

The capital injection of £4m into LVPL has been classified as Initial funds (Tier 1) because there is no requirement for LVPL to repay this capital.

Analysis of significant changes in own funds during the reporting period

There have been no distributions made to shareholders during the reporting period

	LVPL		
	Day 1 2016 £0	Movement £0	Annual 2016 £0
Eligible own funds			
Tier 1 capital	4,051	-250	3,801
Tier 3 capital	55	-55	-
Total capital	4,106	-305	3,801
Made up by:			
Equity shares	1,000	-	1,000
Initial funds / members' contribution	4,000	-	4,000
Deferred tax	55	-55	-
Reconciliation reserve / surplus	-949	-250	-1,199
Total capital	4,106	-305	3,801
Total eligible own funds to meet SCR	4,106	-305	3,801

- Tier 1 capital includes movements in excess of assets over liabilities, excluding the movement in deferred tax.
- Tier 3 capital represents the deferred tax asset.

Ancillary own funds

At 31st December 2016 there are no ancillary own funds.

Deductions from own funds

At 31st December 2016 there are no deductions from own funds

Explanation of the key elements of the reconciliation reserve

Reconciliation reserve	£000
Retained earnings on a Solvency II basis	(1,200)
Total	(1,200)

Differences between equity as shown in the undertaking's financial statements and the excess of assets over liabilities as calculated for solvency purposes

The following table provides a reconciliation of equity under IFRS to Solvency II excess of assets over liabilities.

	At 31st December 2016
	£000
Analysis of Equity - IFRS	
Ordinary shares, allotted and fully paid	1,000
Capital reserves	4,000
Retained losses	(798)
Total Equity - IFRS	4,202
Solvency II Adjustments (excluding reclassifications)	
<u>Assets</u>	
- Reduction in valuation of DAC (Section D1 note 1)	(627)
- Reduction in valuation of reinsurance recoverable (Section D1 note 3)	(408)
- Reduction in valuation of insurance and intermediaries recoverable (Section D1 note 4)	(1,157)
	(2,192)
<u>Technical provisions</u>	
- Decrease in valuation of technical provisions (Section D2)	1,439
<u>Other liabilities</u>	
- Decrease in payables	351
	351
Total Equity - solvency basis	3,800
Restricted own fund items due to ring fencing	-
Restricted own fund items due to subordinated liabilities	-
Total own funds - solvency basis	3,800
Excess of Assets over Liabilities - solvency basis	
Total Assets	3,604
Total Technical Provisions	202
Total Other Liabilities	(6)
Excess of Assets over Liabilities - solvency basis	3,800

Differences in the asset and liability valuation methodology used for solvency purposes and that used under IFRS, are set out in Section D.

Own-fund item that is subject to the transitional arrangements

LVPL has no own funds subject to transitional measures.

E.2 SCR and MCR

E2.1 SCR and MCR

The following table shows the amount of the SCR and MCR for LVPL:

	£000
Solvency Capital Requirement (SCR)	1,175
Minimum Capital Requirement (MCR)	2,251

The SCR increased by £58k during 2016 largely due to new business. The approach adopted for calculation of the SCR is the same as that described in the Group section.

The MCR was the biting capital requirement. The calculation of the MCR is laid out in the S.28.01.01 QRT included with this report. The MCR is determined using a calculation, as specified in the Solvency II regulations, involving the technical provision, capital at risk and SCR, subject to a floor specified in Euros and converted to pounds sterling. For LVLC the biting requirement is the absolute floor of the MCR, set equal to €2.5m Euros and converted to pounds sterling. The MCR increased by £455k during 2016 due to the change in the Euro/Pound exchange rate.

E2.2 Group SCR split by risk

The following table summarises the risk modules which contribute to the SCR for LVPL applicable under standard formula. Year-end 2016 – all figures in £000s

Risk Module	Semi Diversified* Capital Requirement
Market Risk	404
Credit Counterparty Risk	1
Non-Life Underwriting Risk	992
Total before diversification	1,396
Diversification	(235)
Basic Solvency Capital Requirement	1,161
Operational Risk	14
Loss Absorbency of Deferred Taxes	0
Other Adjustments	0
Solvency Capital Requirement	1,175

*Individual Market Risks are diversified to give the total Market Risk Capital Requirement. Similarly, Individual Non-Life Underwriting Risks are diversified to give the total Non-Life Underwriting Risk Capital Requirement.

E.2.3 Diversification benefit)

See Group section E.2.2

E2.4 Basis of calculation

LVPL uses a Standard Formula basis to calculate the SCR. The approach to calculating the SCR and MCR is in accordance with the Solvency II Directive. LVPL is not using any material simplifications or undertaking specific parameters in the calculation of the SCR and does not have any regulatory capital add-ons.

E.3 Use of a duration-based equity risk sub-module

LVPL has not applied the duration-based equity risk sub-module in the calculation of the SCR.

E.4 Differences between Standard Formula and any Internal Model used

This does not apply as LVPL does not use an Internal Model to calculate its SCR.

E.5 Non-compliance with the MCR and the SCR

LVPL has maintained Own Funds in excess of the MCR (and hence the SCR) throughout the reporting period.

E.6 Any other material information

There is no additional material information regarding capital management to disclose in this section.

LVIC SFCR

A. Business and Performance (LVIC)

A.1 Business

a) Name and legal form of undertaking

Liverpool Victoria Insurance Company Limited is a UK-incorporated and domiciled company limited by shares.

For the contact details of LVIC please see part a) in chapter A1 of the Group section of this report.

b) Name and contact detail of the supervisory authority responsible for financial supervision.

Firm's reference number: 202965

The Prudential Regulation Authority is responsible for the financial supervision of the company.

For the contact details of the PRA please see part b) in chapter A1 of the Group section of this report.

c) Name and contact details of the external auditor

For information on the external auditor of LVIC please see part c) in chapter A1 of the Group section of this report.

d) Description of the holders of qualifying holdings in the undertaking

For a description of 'qualifying holdings' please see part d) in chapter A1 of the Group section of this report.

LVIC is a wholly owned indirect subsidiary of LVFS.

For an illustration of the qualifying holdings up to LVFS please see part e) in chapter A1 of the Group section of this report.

e) Details of the undertakings within the group

For an explanation of the undertakings position within the group please see part e) in chapter A1 of the Group section of this report.

f) Material lines of business and material geographic areas.

Materially LVIC underwrites non-life insurance contracts within the UK.

LVIC conducts general insurance business through both the direct and broker distribution channels. The primary sources of premium income are from the sale of Motor insurance products, Home insurance products and Insurance for Small and Medium Size Enterprises ('SME'). Motor insurance products include Private Car, Motorcycle and Commercial Vehicles (hire and reward). LVIC also underwrites Road Rescue, Pet and Travel Insurance.

As such the following Solvency II non-life lines of business are written on either a standalone or bundled product basis:

- Motor vehicle liability insurance
- Other motor insurance
- Fire and other damage to property insurance
- General liability insurance
- Legal expenses insurance
- Assistance

g) Significant business or other events occurring during the reporting period that have a material impact on the undertaking.

Solvency and Financial Condition

LVIC's year-end 2016 trading results and capital position were impacted by the reduction in the Ogden discount rate announced by the Lord Chancellor on 27 February 2017.

On an Standard Formula basis the capital surplus after the impact of Ogden stood at £33m with capital cover at 108%

In order to strengthen LVIC's capital position consistent with its risk appetite LVIC received a capital injection of £40m on 28 February 2017. This capital was provided by LVFS via LVGIG and took the form of additional ordinary shares.

Business and Performance

The profit before tax and before the impact of the Ogden discount rate change, was £86 million, a 31% increase compared to 2015. This reflects strong investment returns and a strong increase on the underwriting result. On 20 March 2017 the Ogden discount rate reduced from 2.5% to -0.75% with a consequent increase in our technical provisions. The 2016 results for LVIC after the impact of the Ogden rate change show a loss before taxation of £20 million (2015: profit £65 million).

LVIC (£m)	2016	2015
Net earned premium	917	896
Net claims incurred	(713)	(556)
Expenses incurred	(289)	(333)
Net underwriting result	(85)	7
Net investment income	28	23
Other	37	35
Net (Loss) / Profit before tax	(20)	65

All income statement numbers presented in Section A. are based on the IFRS Financial Statements adjusted for certain presentational adjustments made in the QRTs. Profit before tax is the same under both presentations.

System of Governance

There have been no significant changes in LVIC's system of governance in the year. The table below summarises the changes in membership of the Board in the year:

P M Bunker - Resigned 1st January 2016	M P Crane - Appointed 1st January 2016
S V Castle - Resigned 19th September 2016	C Burton - Appointed 1st October 2016
S R Haynes - Resigned 1st October 2016	D Neave - Appointed 1st October 2016
J M Laidlaw - Resigned 1st October 2016	K O'Keeffe - Appointed 1st October 2016
J B O'Roarke - Resigned 5th May 2016	S Treloar - Appointed 5th May 2016
M J Rogers - Resigned 28th July 2016	
R A Warner - Resigned 1st October 2016	

A.2 Underwriting performance

Net Underwriting Result – 2016

The following table shows the underwriting income and expenses as presented in the financial statements.

All business is underwritten in the UK and the following provides an analysis of the underwriting income and expenses for 2016 in addition to a comparative for 2015.

A Loss Portfolio Transfer agreed in December 2015 with 20% of Claims reserves ceded to the reinsurer. A whole account 20% quota share arrangement effective 1st January 2016 to December 2018 has been placed.

For explanations of the 2016 underwriting performance by line of business and an analysis for the material variances compared to previous year please refer to section below.

The ratios have been calculated as follows:

- Claims ratio = Net claims incurred ÷ Net earned premiums
- Expense ratio = Expenses incurred ÷ Net earned premiums
- Combined ratio = (Net claims incurred + Expenses incurred) ÷ Net earned premiums

The 2015 expense ratio was adversely impacted by the Loss Portfolio Transfer agreed in December 2015 with 20% of Claims reserves ceded to the reinsurer and an equivalent reduction to net earned premium and net claims incurred.

Comparison of Underwriting Performance - 2016 to 2015

LVIC - 2016 Actual Underwriting Result (£m)	Motor vehicle liability insurance	Other motor insurance	Fire and other damage to property insurance	General liability insurance	Legal expenses insurance	Assistance	Total
Net earned premiums	467	161	200	17	23	49	917
Net claims incurred	(408)	(140)	(125)	(10)	(2)	(28)	(713)
Expenses incurred (excluding investment management expenses)	(136)	(47)	(83)	(8)	(4)	(12)	(289)
Underwriting result	(77)	(26)	(8)	(1)	17	9	(85)

Claims Ratio	87.4%	87.0%	62.5%	58.8%	8.7%	57.1%	77.8%
Expense Ratio	29.1%	29.2%	41.5%	47.1%	17.4%	24.5%	31.5%
Combined Ratio	116.5%	116.1%	104.0%	105.9%	26.1%	81.6%	109.3%

LVIC - 2015 Actual Underwriting Result (£m)	Motor vehicle liability insurance	Other motor insurance	Fire and other damage to property insurance	General liability insurance	Legal expenses insurance	Assistance	Total
Net earned premiums	445	153	209	18	23	48	896
Net claims incurred	(284)	(98)	(138)	(12)	(1)	(24)	(556)
Expenses incurred (excluding investment management expenses)	(156)	(54)	(94)	(9)	(4)	(16)	(333)
Underwriting result	5	1	(23)	(3)	18	8	7

Claims Ratio	63.8%	64.1%	66.0%	66.7%	4.3%	50.0%	62.1%
Expense Ratio	35.1%	35.3%	45.0%	50.0%	17.4%	33.3%	37.2%
Combined Ratio	98.9%	99.3%	111.0%	116.7%	21.7%	83.3%	99.2%

LVIC - 2016 versus 2015 Actual Underwriting Result Variances (£m)	Motor vehicle liability insurance	Other motor insurance	Fire and other damage to property insurance	General liability insurance	Legal expenses insurance	Assistance	Total
Net earned premiums	22	8	(9)	(1)	0	1	21
Net claims incurred	(124)	(42)	13	2	(1)	(4)	(157)
Expenses incurred (excluding investment management expenses)	20	7	11	1	0	4	44
Underwriting result	(82)	(27)	15	2	(1)	1	(92)

As there are some minor differences in the accounting treatments required under Solvency II versus the financial statements, the Solvency II data tables have been reconciled to the financial statements as follows:

	2016	2015
	£m	£m

Net earned premium per the financial statements	917	896
Net total per Solvency II	917	896

Net claims incurred per the financial statements	(753)	(603)
Less claims management costs (net of reinsurance)	40	47
Net total per Solvency II	(713)	(556)

Operating expenses per the financial statements	(252)	(288)
Add claims management costs (net of reinsurance)	(39)	(47)
Less investment management expenses	2	2
Net total per Solvency II	(289)	(333)

Market conditions have remained competitive, particularly in Motor. The Motor market in general is now supporting price increases so volumes are continuing to remain stable. LVIC has therefore been able to hold its competitive position. In addition to this, it has continued its strategy to diversify its reliance upon Motor through growth in the SME and Direct Home lines of business.

During 2016 the impact of the change in the Ogden rate from 2.5% to -0.75% has seen LVIC's result before tax move from a £86 million profit, to a £20 million loss. LVIC also saw adverse current year claims experience affecting the claims performance. Underlying claims costs were hit by the increased costs of putting right damage to vehicles, mainly third parties.

In response to the competitive market conditions LVIC has maintained strong cost disciplines through controlling acquisition costs and operating expenses during the year. Nevertheless, investment in staff, systems, marketing and infrastructure has continued to ensure that it is well placed to deliver its profitable growth strategy. LVIC has continued to implement a major multi-year project aimed at replacing the Direct Division front systems to ensure that it is well positioned for future challenges. Overall expenditure has decreased, with favourable impacts from commissions and lower than expected costs.

The underwriting result initially remained strong during 2016 but has since been impacted significantly by the drop in the Ogden rate, delivering a combined ratio of 105.3% (2015: 95.3%). The reserves have now been strengthened by £113 million to account for the movement in the Ogden discount rate. The high level of reserve run-off seen during the prior year was mostly due to favourable claims experience development trends. This was an exceptional set of circumstances which wasn't expected to be repeated in 2016.

A.3 Investment performance

The following table summarises the income and expenses with respect to investment activities during the last reporting period together with a comparison of the information with that reported on the previous reporting period:

	2016	2015
	£m	£m
Dividend income	9	11
Interest income	32	44
Realised and unrealised gains/(losses)	(11)	(29)
Investment expenses	(2)	(3)
Total Investment Performance	28	23

Investment returns were positive over 2016 due to the strong performance from equities and credit bonds. The continued low underlying interest rate market resulted in low income returns but this was offset by higher capital returns in Equities and Corporate bonds.

The following tables summarises the undertaking's overall investment performance during the current and previous reporting periods by relevant asset class:

2016 Asset class (£m)	Dividends	Interest	Realised / Unrealised gains / losses	Total	Average investment holding during 2016	Average investment return
Government bonds	-	5.2	(0.1)	5.1	248.0	2.04%
Corporate bonds	-	26.2	(9.3)	16.9	648.5	2.61%
Equity	2.5	-	-	2.5	216.2	1.13%
Collective investment undertakings	6.9	-	15.3	22.2	285.5	7.78%
Collateralised securities	-	0.4	(0.2)	0.2	6.0	3.79%
Cash and deposits	-	0.1	-	0.1	250.0	0.06%
Put Options / Swaps / Futures / Forwards	-	-	(16.7)	(16.7)	N/A	N/A
Total	9.3	32.0	(11.0)	30.3		
Less investment expenses				(1.9)		
Net total				28.4		

2015 Asset class (£m)	Dividends	Interest	Realised / Unrealised gains / losses	Total	Average investment holding during 2015	Average investment return
Government bonds	-	10.6	(7.5)	3.1	286.5	1.08%
Corporate bonds	-	32.5	(21.3)	11.2	615.5	1.82%
Equity	2.8	-	-	2.8	0.7	400%
Collective investment undertakings	7.8	-	2.1	9.9	228.5	4.33%
Collateralised securities	-	0.5	(0.3)	0.2	26.0	0.77%
Cash and deposits	-	0.3	-	0.3	338.0	0.09%
Put Options / Swaps / Futures / Forwards	-	-	(1.7)	(1.7)	0.8	N/A
Total	10.6	43.9	(28.7)	25.8		
Less investment expenses				(2.5)		
Net total				23.3		

A.4 Performance of other activities

The following items have been identified as material income and expenses, other than underwriting or investment income and expenses:

	2016 £m	2016 £m
Other income	37	35
Tax charges	6	(11)
Total	43	24

Other income is predominantly driven by interest amounts charged to policy holders who pay for their general insurance on a monthly basis compared to fully paying for the insurance at the time of purchase. It also includes profit share relating to the quota share arrangement. Whilst LVIC cedes 20% of the business to the reinsurer, the maximum margin available to them is 1.75% with any surplus returned to LVIC as profit share on commutation. In addition there is credit Hire Income received.

The tax charge is calculated based on the IFRS Profits and Losses reflecting the underwriting performance, investment performance and tax deductible movements on intangible assets. In addition deferred tax is recognised on timing differences relating to capital allowances in excess of depreciation and any tax losses carried forward. A deferred tax liability in relation to Intangible Assets exists where the IFRS accounts value is greater than the tax written down value. Offset against this deferred tax liability is the deferred tax asset relating to capital allowances in excess of depreciation. Deferred tax assets and liabilities can be offset where there is a legal right of offset when the taxes involved are levied by the same taxation authority, as is the case here.

Where a tax loss arises (as in 2016 due to the impact of Ogden), the tax loss is carried back against any tax paid in the previous period. Any remaining loss is carried forward and Board Approved Business Plans are required to evidence and support the future recovery of the Deferred Tax Asset by the utilisation of future available taxable profits.

A.5 Any other information

There is no additional information to disclose for section A because all relevant information has been provided above.

B. System of Governance (LVIC)

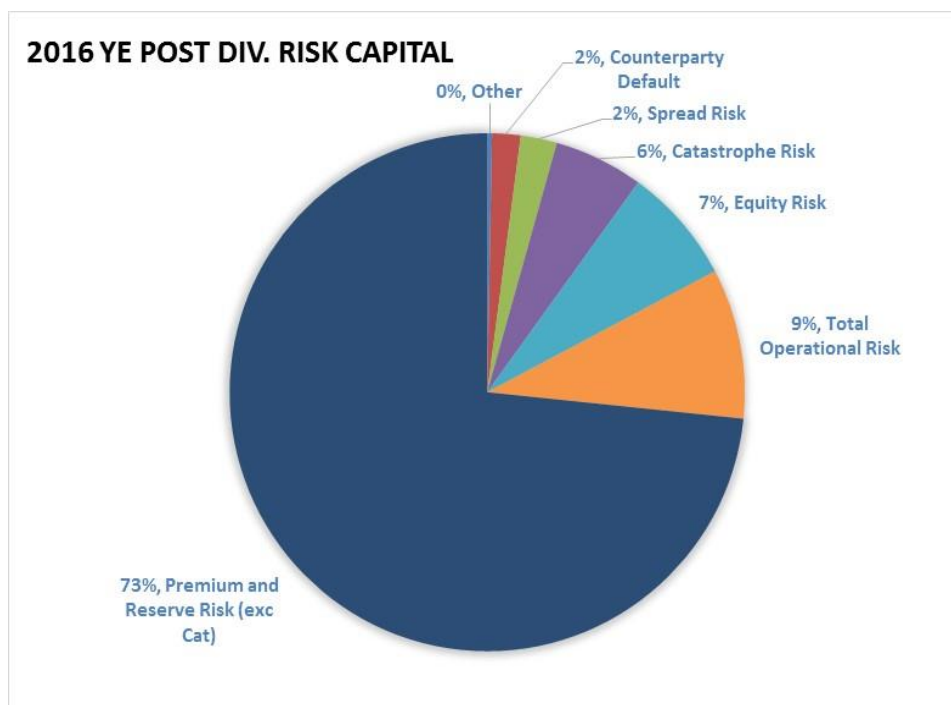
The system of governance for LVIC is described in Section B of the Group section of this report.

C. Risk Profile (LVIC)

C.1 Overview

C.1.1 Overview of risk exposures

The chart below shows the year-end 2016 split of the Standard Formula Solvency Capital Requirement (SCR) by risk type. The largest exposure relate to Underwriting Risk with 73% followed by Catastrophe, Equity and Operational Risk all with between 5 and 10%.



C.1.2 Measurement of risk exposures

A group wide approach is taken in measuring risk exposures. This is described within the main LVFS Group SFCR in section C1.2.

C.1.3 Prudent person principle

A common investment framework is employed across the LVFS Group and its subsidiaries. This is set out within the main LVFS Group SFCR in section C1.3.

C.1.4 Risk concentration

This is described within the main LVFS Group SFCR in section C1.4.

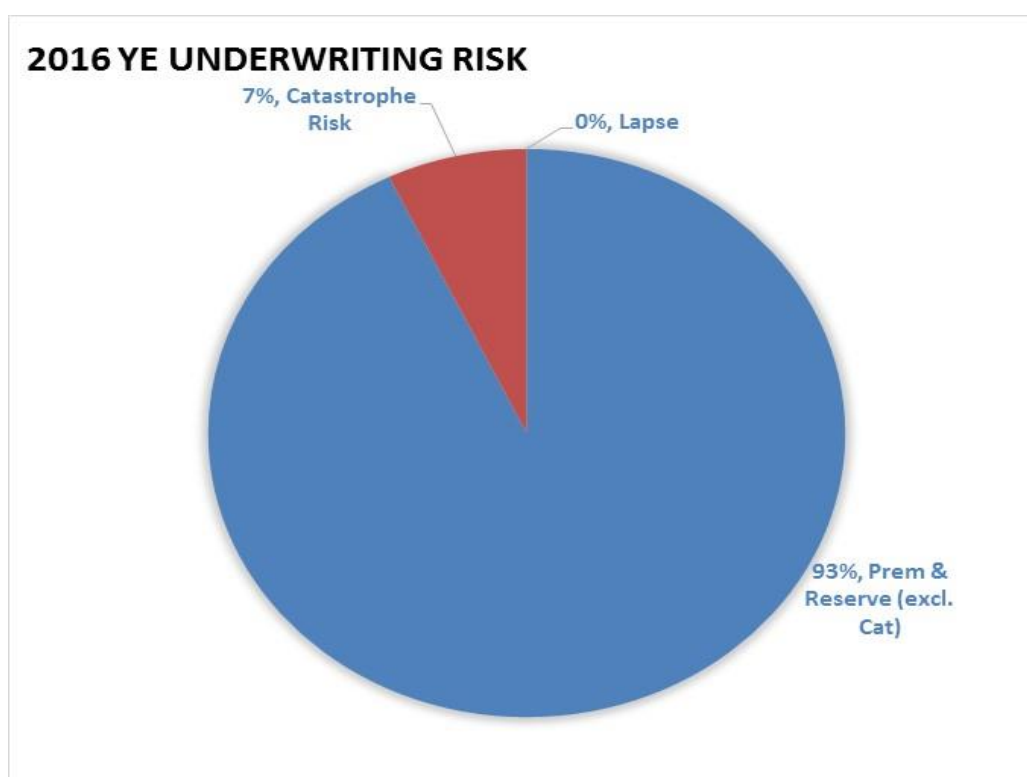
C.2 Underwriting risk

C.2.1 Underwriting risk exposure

These are described within the main LVFS Group SFCR in section C2.1.

LVIC's Underwriting Risk is primarily driven by the uncertainty in the amount of claims and expenses it incurs from both expired risk and unexpired risk and in relation to the level of premiums to be written on future new business. This is captured within the Premium and Reserve Risk component which dominates Underwriting Risk. Catastrophe Risk is defined as the risk that losses from catastrophe events differ from expected. This could be due to a divergence from expectations in either the claim frequency and/or average claim severity. LVIC writes household and commercial insurance business which are exposed to Natural Catastrophe events, specifically flood and windstorms.

Lapse Risk is modelled explicitly within the Standard Formula and is the risk that profitable policies lapse over the one-year time horizon. Within the Internal Model, this risk is captured within Premium Risk.



C.2.2 Material changes over the reporting period

The change to the Ogden discount rate detailed in the LVFS Group SFCR, section C2.2, was the most significant change experienced by LVIC during the period. Additionally, there was a reduction in catastrophe risk following changes to the reinsurance programme.

C.2.3 Risk mitigation techniques

Reinsurance purchase is the main tool used to keep underwriting exposure within risk appetite. This is discussed in section C2.3 of the LVFS Group SFCR.

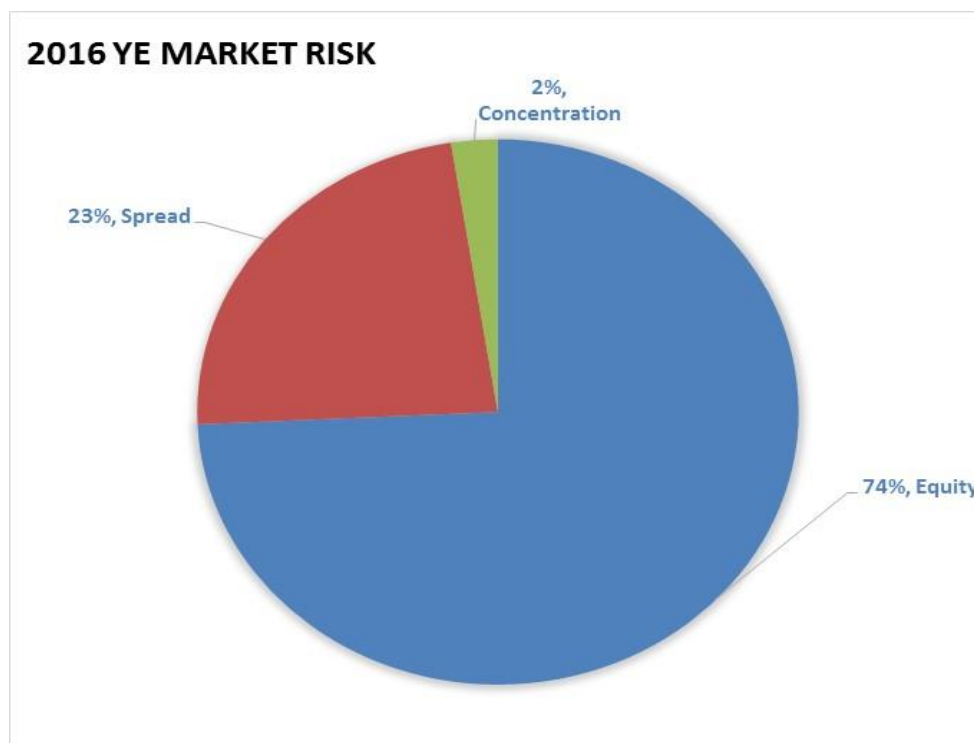
A range of reinsurance contracts are entered into, typically annually, across the motor, household and commercial property businesses to mitigate the risk of large losses and catastrophe events. In addition, Loss Portfolio Transfer and Whole Account Quota Share programmes have been entered into to cede a portion of risk out of the entity.

C.3 Market risk

C3.1 Market risk exposure

Market risk is managed at the Group level and the specific risk exposures are described further in section C3.1 of the main LVFS Group SFCR.

Within market risk the key exposure is to Equity Risk which comprises 74% of the SCR post-diversification. Spread Risk is the next largest exposure at 23%, with LVIC having a relatively large exposure to corporate bonds.



C3.2 Material changes over the reporting period

Interest rate Risk has reduced due to the implementation of hedging strategies and a reduction in Periodic Payment Order (PPO) liabilities, which are longer term than typical General Insurance liabilities, following the reduction in the Ogden discount rate.

C3.3 Risk mitigation techniques

This is discussed in the LVFS Group SFCR, Section C3.3.

C3.4 Risk concentrations

This is discussed in the LVFS Group SFCR, Section C3.4, with no significant additional risk concentrations at the LVIC entity level.

C.4 Credit counterparty risk

This is discussed in the LVFS Group SFCR, Section C4.

LVIC has exposure to a single AA-rated reinsurer following a Loss Portfolio Transfer (LPT) and Whole Account Quota Share (QS) arrangement where a portion of risk was ceded away.

C.5 Other material risks

Liquidity, operational and other risks are managed at a LVFS Group level and are described further in section C5, C6 and C7 of the LVFS Group SFCR.

C.6 Sensitivities

As Premium and Reserve risk dominate the SCR we show stresses on these components. The table below shows the impact on the SCR of both increases and decreases and we see that the impact is very symmetrical.

Sensitivities		Impact	
Item	Size	£m	%
Baseline SCR		427	
Premium Risk	10% increase (rates down or loss ratios up)	8	1.8%
Premium Risk	10% decrease (rates up or loss ratios down)	-7	-1.7%
Reserve Risk	10% increase (Ogden type shock)	33	7.6%
Reserve Risk	10% decrease (Ogden type shock)	-31	-7.4%
Catastrophe Risk	(+25% increase in 1:200 gross loss)	2	0.5%
Catastrophe Risk	(+25% decrease in 1:200 gross loss)	-2	-0.4%

For Premium risk we looked at scenarios which would increase (or decrease) this risk by 10% alone. This could either be as a result the impact of a reduction in premium rates or some change in business mix which lead to a deterioration in loss ratio.

Within Reserve risk we look at the impact of a shock of 10% on reserve risk which might emerge form an Ogden or LASPO type event.

D. Valuation for Solvency Purposes (LVIC)

D.1 Assets

For solvency valuation purposes, assets and liabilities are valued consistently with IFRS provided that IFRS valuation methods are consistent with Article 75 of Directive 2009/138. Assets and liabilities represent the fair value amount for which they could be exchanged between knowledgeable willing parties in an arm's length transaction.

The financial statements of the undertaking have been prepared in accordance with:

- International Financial Reporting Standards (IFRS), as endorsed by the European Union ('EU')
- International Financial Reporting Interpretations Committee ('IFRIC')
- Statement of Recommended Practice issued by the Association of British Insurers (2005), amended 2006 and;
- those parts of the Companies Act 2006 applicable to companies reporting under IFRS.

	Note	2016			
		IFRS £m	Presentational adjustment £m	Solvency valuation adjustment £m	Solvency £m
Goodwill	1	16	-	(16)	-
Deferred acquisition costs	2	74	-	(74)	-
Intangible assets	#	2	-	(2)	-
Deferred tax assets	3	-	-	14	14
Investments					
- Participations	4	301	-	(93)	208
- Equities	5	1	-	-	1
- Bonds	5	745	320	-	1,065
- Collective Investment Undertakings	5	269	-	-	269
- Deposits other than cash equivalents	5	149	(112)	-	38
Reinsurance recoverables	6	302	-	(21)	281
Insurance and intermediaries receivables	7	219	-	(219)	-
Reinsurance receivables	#	13	-	(13)	-
Receivables (trade, not insurance)	#	49	-	-	49
Cash and cash equivalents	8	205	(196)	-	9
Any other assets, not elsewhere shown	9	38	(12)	-	26
Total Assets		2,383	-	(424)	1,960

#= Disclosure note not provided as solvency value equal to IFRS or the amounts are immaterial.

Supporting Notes

1. Goodwill

For Solvency II valuation purposes, goodwill is valued at nil.

2. Deferred acquisition costs

For Solvency II valuation purposes, deferred acquisition costs are set to nil however the cashflows relating to DAC-able expenses, are included within the Technical Provisions valuation if they fall within the projected timeframes (see D2. Technical Provisions). Under IFRS, the proportion of the costs of acquiring new general insurance business which relate to unearned premiums are deferred and recognised as an asset to the extent that they are recoverable out of margins in future matching revenues.

Acquisition costs comprise all allowable costs incurred in writing new contracts. Deferred acquisition costs are amortised over a period which is consistent with the assessment of the expected pattern of receipt of future revenue margins for each product type.

All deferred acquisition costs are tested for recoverability at each reporting date. The carrying values are adjusted to recoverable amounts and any resulting impairment losses are charged to the Statement of Comprehensive Income.

3. Deferred tax assets

Under IFRS, there is no deferred tax asset as the timing difference relating to intangible assets less capital allowances in excess of depreciation gives rise to a deferred tax liability.

	£m
Deferred tax assets per the statutory financial statements	-
Solvency II Valuation Adjustment	14
Deferred tax assets- solvency valuation	14

There are a number of changes that need to be made to the IFRS Balance Sheet on the move to Solvency II which impact the Solvency II profit and the Deferred Tax provision established to recognise the timing differences arising. These relate to the changes in the valuation of goodwill, intangible assets, reserves, insurance recoveries and payables.

The impact of these changes is that there is a decrease in the taxable profits of £73m. The recoverability of this DTA requires justification in the same manner as required for a DTA on the IFRS Balance Sheet. The recoverability of the losses arising from a move to Solvency II has been justified based on Board Approved Business Plans. These profits demonstrate that the timing differences arising from IFRS accounting and tax treatment plus the timing differences arising from the move to Solvency II results are fully covered and utilised by future taxable profits at the prevailing CT rates at times of recovery. The future profits projections utilised ensure that profits cannot be inadvertently counted twice. The reversal of the risk margin is not included in the profit projections.

The total taxable loss of £73m has been justified based on the Board Approved Business Plans over the period 2017 to 2018. The DTA established over this period is based on the announced Corporation Tax rates, as follows.

Year	Loss Utilised (£m)	CT Rate	DTA (£m)
2017	60.8	19.25%	11.7
2018	12.2	19.00%	2.3
Total	73.0		14.0

4. Participations

Under IFRS participations are held at cost less any provision for impairment. For Solvency II valuation purposes participations are not included at their carrying value, as they are under IFRS. For insurance undertakings, the adjusted equity valuation method was used. For non-insurance undertakings, the equity valuation method was used with a deduction for the value of goodwill or other intangible assets that would be valued at zero.

	£m
Shares in subsidiaries	301
Loan stock in subsidiaries	-
Investments in group undertakings - IFRS	301

Joint venture properties reclassified as participations	-
Adjusted equity method valuation differences	(93)
Participations -solvency valuation	208

5. Equities, Bonds, Investment Funds, Deposits other than cash equivalents, other investments, Loans and mortgages

For solvency valuation purposes, financial assets are valued consistently with IFRS. However there are also there are mapping differences between the IFRS and Solvency II hierarchies which certain assets such as Collective Investment Undertakings are presented differently under IFRS.

Under IFRS, financial assets are valued at fair value through which income has two sub categories:

- Financial assets held for trading; and
- Those designated at fair value through income at inception.

Derivatives are classified at fair value through income as they are held for trading. Financial assets designated at fair value through income at inception are measured at market prices, or prices consistent with market ratings should no price be available. Day one gains are recognised only where valuations use data from observable markets. Any unrealised or realised gains or losses are taken to the Statement of Comprehensive Income, as fair value gains or losses, or realised gains or losses respectively, as they occur.

Financial assets at fair value through income; further information is provided in the table below.

Fair value estimation

For solvency valuation purposes, the fair value measurement hierarchy is as follows:

- Quoted market prices in active markets for same assets and liabilities (QMP). This is the default valuation method and is broadly consistent with Level 1 category assets under IFRS.
- Quoted market price in active markets for similar assets (QMPS). Maximum use is made of relevant market inputs such as quoted prices for identical or similar assets in an inactive market, observable inputs other than quoted prices and market corroborated inputs derived from observable market data. This is broadly consistent with Level 2 category assets under IFRS.
- Other alternative valuation method (AVM). Unobservable inputs reflecting the assumptions market participants would use when pricing the asset or liability, including assumptions about the risk inherent in both the inputs and the valuation technique. The undertaking uses various valuation approaches, including market, income and cost approaches. This is broadly consistent with Level 3 category assets under IFRS.
- Adjusted Equity Method (AEM) for Participations

The following table presents the financial assets measured at fair value at 31st December 2016.

	QMP	QMPS	AVM	AEM	Total
	£m	£m	£m	£m	£m
Holdings in related undertakings, including participations	-	-	-	208	208
Equities	-	-	1	-	1
Bonds	544	521	-	-	1,065
Collective Investments Undertakings	269	-	-	-	269
Deposits other than cash equivalents	38	-	-	-	38
Investments	851	521	1	208	1,581

6. Reinsurance recoverables

The undertaking cedes insurance risk in the normal course of businesses. Reinsurance assets represent balances recoverable from reinsurance companies.

For solvency valuation purposes, reinsurance recoverables are valued using the cash-flow projection method and in a consistent manner with the calculation of the best estimate liabilities (see D2. Technical provisions). In calculating reinsurance recoverables under Solvency II, adjustments are made for the time difference between recoveries and direct payments and also for expected losses due to the default of a counterparty. The adjustment is based on an assessment of the probability of default of the counterparty and the average loss resulting therefrom (loss-given-default).

Under IFRS, recoverable amounts are estimated in a manner consistent with the outstanding claims provision. Reinsurance premiums are recognised in the same period as the underlying contract that they relate to.

	£m
Reinsurers' share of provision for unearned premiums	17
Reinsurers' share of claims liabilities	285
Total Reinsurance Recoverables - IFRS	302
Best estimate liability adjustments	(21)
Total reinsurance recoverables - solvency valuation	281

7. Insurance and intermediaries receivables

For solvency valuation purposes, any future premiums (included in insurance receivables) which fall due after the valuation date and any premium debts (included within intermediaries receivables), are subject to best estimate liability calculation of technical provisions (see D2. Technical Provisions).

Under IFRS, insurance and intermediaries receivables are recognised when due and include amounts due from policy holders, agents, brokers and intermediaries. Insurance and intermediaries receivables are initially recognised at fair value and then subsequently held at amortised cost. Where there is objective evidence that the carrying value is impaired then the impairment loss will be recognised in the statement of comprehensive income.

	£m
Due from policyholders	172
Due from agents, brokers and intermediaries	47
Total Insurance and intermediaries receivables -IFRS	219
Best estimate liability adjustments	(219)
Total Insurance and intermediaries receivable- solvency valuation	-

8. Cash and cash equivalents

For solvency valuation purposes, cash is valued consistently with IFRS with a reclassification adjustment for short term bank deposits which are included in investments (other than assets held for index-linked and unit-linked funds) as deposits other than cash equivalents due to the CIC code assigned to them.

Under IFRS, cash and cash equivalents comprise cash at bank and in hand, and short-term deposits with an original maturity of three months or less. These are valued at fair value based on amounts receivable on demand.

	£m
Bank Balances	9
Short term bank deposits	196
Total cash and cash equivalents -IFRS	205
Reclassify short term deposits into Investments: deposits	(196)
Total cash and cash equivalents - solvency valuation	9

9. Any other assets, not elsewhere shown

For solvency valuation purposes, prepayments and accrued income are valued consistently with IFRS. On the Solvency II balance sheet, the accrued interest on bonds is included in the market value of Investments.

Under IFRS, prepayments and accrued income balances are all due within one year. These are valued at fair value based on amounts receivable on demand.

	£m
Accrued interest	13
Other prepayments and accrued income	12
Corporation tax asset	13
Prepayments and accrued income - IFRS	38
Reclassify accrued interest on bonds to Investments	(12)
Total any other assets, not elsewhere shown - solvency valuation	26

D.2 Technical provisions

The technical provisions are calculated as the sum of the claims provisions, premium provisions and the risk margin. The table below summarises the technical provision recorded as at year end 2016:

LVIC (£ms)	Total	Motor Liability	Motor Other	Property Damage	General Liability	Legal Expenses	Assistance	Life excl Health
Gross Claims Provision	1,069	893	-24	92	55	2	6	45
Gross Premium Provision	305	162	62	67	9	-3	8	0
Gross BEL	1,373	1,055	38	159	64	-1	14	45
Risk Margin	61	39	2	4	3	0	0	12
Technical Provisions	1,434	1,094	39	163	67	-1	15	57

The 'Life Excl Health' Line of Business relates purely to claims that have settled as a Periodic Payment Order (PPO) whereby the claimant is granted, in addition to a lump sum payment on settlement, a regular income for life to pay for future care costs and loss of earnings. Such payments are generally linked to an inflation index representing the expected increases in salaries for care workers.

Methods and main assumptions

The business estimates the technical provisions using a range of standard actuarial and statistical techniques. This includes, where appropriate, stochastic models.

For attritional claims, these methods rely primarily on the 'chain-ladder' methods which use historic claim development triangles to attempt to predict the future development of claims which are reported but not settled and claims that are yet to be reported. For more recent periods, trended methods are adopted.

For non-PPO large claims a separate stochastic method is adopted that assumes claims settle with a severity that is consistent with a standard statistical distribution. For large claims that are yet to be reported a similar stochastic model is used but which additionally allows for an assumed distribution of the frequency of claims to be reported that differs by reporting delay.

For PPO claims a cashflow model is used. The primary assumptions made relate to future wage inflation for care workers, investment returns (by which cashflows are discounted), base mortality of claimants and any expected reduction in life expectancy due to the severity of the injuries suffered by the claimant.

The premium provision is the discounted cashflow in respect of premium receivables, claims and expenses arising from incepted unearned and un-incepted business. The undiscounted cash-flows are calculated using a suite of assumptions and are grouped into the Solvency II Lines of Business. The unearned premium and un-incepted premium runs-off over the subsequent twelve months and is adjusted to allow for several factors affecting claims and expenses. The claims and expenses generated from the unexpired risk are calculated and a cashflow produced, in line with the methodology employed in the calculation of the Claim Provision and allows for both reinsurance and the reinsurer default risk. Discounting these cashflows by the Solvency II lines of business produces the Solvency II Premium Provision.

Expenses and other cashflows associated with the servicing of claims and policies are allowed for. As are events that are not in the data (ENIDs).

Future cashflows used for the calculation of the Solvency II technical provisions are derived from payment patterns consistent with the IFRS ABE. All cashflows under Solvency II are discounted using the risk-free rate as imposed by EIOPA.

Risk Margin

The risk margin is calculated as required by the Solvency II regulations. The RM Model has developed from that used for the 2009 CEIOPS QIS5 exercise. The main change made to these models to form the Solvency II RM Model was a move from the template provided by CEIOPS for the QIS5 exercise to facilitate the RM calculation to an in-house model, designed to allow for the internal model output as well as standard formula output.

Under QIS5 there were five options allowed for determining the projected SCR figures:

- 1 Make a full calculation of all future SCRs without using simplifications.
- 2 Approximate the individual risks or sub-risks within some or all modules and sub-modules to be used for the calculation of future SCRs.
- 3 Approximate the whole SCR for each future year, e.g. by using a proportional approach.
- 4 Estimate all future SCRs "at once", e.g. by using an approximation based on the duration approach.
- 5 Approximate the risk margin by calculating it as a percentage of the best estimate.

We have adopted Option 1 for the Standard Formula Basis.

All methods are supplemented by regular interaction with Claims and Underwriting functions.

Uncertainty

Insurance is a business based around uncertainty. In calculating the technical provisions judgement is used in deciding appropriate models to use and in calibrating the models. As such, there is inherent uncertainty around the value of the technical provisions both in terms of the amount and timing of future cashflows. The ENIDs aims to capture this uncertainty.

ENIDS

The approach used to derive the ENIDs loading has considered a combination of the scenarios for the large claims and catastrophic events, and a mean load statistical approach for the attritional claims. The statistical approach for attritional claims builds on a presentation at the Reserving Seminar 2016 which provided an alternative approach to the Lloyd's Truncated Statistical Distribution approach called the mean load approach. The data segmentation is by product and the loadings derived are split by product.

Differences in valuation methodologies

The Solvency II BEL is very much based upon the IFRS ABE. However, elements of the ABE which are required under IFRS are not required under Solvency II and vice versa. Broadly, these can be summarised as follows:

- Past Deferred Acquisition Costs are not included in the cashflow projections. However, the future DAC-able expenses in the unaccepted business are included.;
- An explicit claims margin is inadmissible under Solvency II. However this is replaced by an allowance for Events Not In Data (ENIDs) which is calculated using standard actuarial techniques;
- Under IFRS where liabilities are discounted (only PPOs) the Group can make an appropriate assumption as to expected asset returns whereas under Solvency II all liabilities (PPOs and non-PPOs) must be discounted using the yield curve specific to the UK as set by EIOPA; and
- The UPR (net of DAC and Premium receivables) under IFRS is inadmissible under Solvency II. However, this is replaced by the premium provision.

Recoverables from reinsurance contracts and special purpose vehicles

The business enters into a number of reinsurance contracts. Most materially this includes an excess of loss arrangement to cover liability-related exposure with a retention set in line with the Group risk appetite. At the 2015 year-end the Group also entered into a General Insurance portfolio-wide Loss Portfolio Transfer arrangement for accident years 2015 and prior inclusive. Simultaneously, the Group entered into a quota share arrangement for the 2016 accident which has been renewed on the same terms for the 2017 accident year.

At present, there are no special purposes vehicles in place for the Group's reinsurance.

Material changes in the relevant assumptions made in the calculation of the technical provisions

The Solvency II BEL relies upon the calculation of the IFRS ABE for many of its assumptions. As such, many of the elements of assumptions are updated throughout the year in line with changes in the IFRS ABE. In particular:

- Cashflow patterns;
- Expenses; and
- Allowance for reinsurer counterparty default.
-

Premium provision assumptions are updated in line with the reforecasting of the business Plan throughout the year.

The methodology for calculation of the ENID has been significantly enhanced throughout the year and mostly follows the method presented at the IFOA Reserving Seminar in June 2016.

As of March 2017, the Ogden discount rate has been changed from +2.5% p.a. to -0.75% p.a. In the interim whilst the underlying claim systems were updated, an estimated impact was applied to the IFRS ABE as at the 2016 year-end allowing for the impact of the incurred, PPO propensity, incurred but not yet reported (IBNYR) and reinsurance. The method allowed for all the large claims, the claims mostly impacted by the change in Ogden Rate, to be recalculated on an individual claim by claim basis on the new rate and revised estimated reinsurance recoveries. The expected IBNR claims and assumed PPO propensity were also adjusted to reflect the new Ogden rate. Smaller claims which are not so materially impacted by the rate change were uplifted by an expected average increase for these type of claims. As such, this overlay does also add to the uncertainty around the technical provisions.

As the source claim systems are updated in April 2017 the estimate will be unwound and replaced with a final calculation which, in the absence of further changes to the rate through 2017, will be reflected in the 2017 year-end position.

D.3 Other liabilities

For Solvency II valuation purposes, assets and liabilities are valued consistently with IFRS provided that IFRS valuation methods are consistent with Article 75 of Directive 2009/138. Assets and liabilities represent the fair value amount for which they could be exchanged between knowledgeable willing parties in an arm's length transaction.

The financial statements of the undertaking have been prepared in accordance with:

- International Financial Reporting Standards (IFRS), as endorsed by the European Union ('EU').
- International Financial Reporting Interpretations Committee ('IFRIC').
- Statement of Recommended Practice issued by the Association of British Insurers (2005), amended 2006 and;
- those parts of the Companies Act 2006 applicable to companies reporting under IFRS.

	Note	2016			
		IFRS	Presentational adjustment	Solvency valuation adjustment	Solvency II
		£m	£m	£m	£m
Deferred tax liabilities	#	1	-	(1)	-
Derivatives	#	15	-	-	15
Insurance and intermediaries payables	#	1	-	-	1
Reinsurance payables	1	21	-	(21)	-
Payables (trade, not insurance)	#	56	-	(7)	49
Total Other Liabilities		94	-	(29)	65

#- Disclosure note not provided as solvency value equal to IFRS or the amounts are immaterial.

With regards Guidelines 21 (1.37) of EIOPA-BoS-15/109⁴, there are no material off-balance sheet assets or liabilities which fall into the scope of this narrative.

⁴ Final Report on public consultation No. 14/047 on Guidelines on reporting and public disclosure

Supporting Notes

1. Reinsurance payables

For Solvency II valuation purposes, debts owed to credit institutions are valued consistently with IFRS.

Under IFRS, reinsurance payables are recognised when due. Where there is objective evidence that the carrying value is impaired then the impairment loss will be recognised in the statement of comprehensive income. Reinsurance payables are initially recognised at fair value and subsequently held at amortised cost.

	£m
Due to reinsurers	21
Total reinsurance payables - IFRS	21
Reinsurance payables included in BEL calculations	(21)
Total reinsurance payables - solvency valuation	-

The maturity profile of the liability recognised in the financial statements is summarised in the following table:

						£m
	Within 1 year	1 - 3 years	3 - 5 years	Over 5 years	UL	Total
Insurance and intermediaries payables	21	-	-	-	-	21

D.4 Alternative methods for valuation

Information is provided for assets valued using alternative methods.

Justification for using alternative methods

The Group aims to use quoted market prices or observable inputs to value all assets and liabilities however where there is no external market or readily observable inputs, the Group will use an alternative method such as discounted cash-flow or mark-to-model.

Assumptions used in valuation approach and areas of uncertainty

Alternative methods for valuation include the use of estimates and assumptions that are not market observable but are based on a combination of internally developed models, calibrated to market observable data where possible as well as independent third-party evidence. Valuation uncertainty arises where there is reliance on third-party adherence to expected valuation standards or potential variation in the expected range of the key inputs into models.

The following material assets have been valued using alternative valuation methods in accordance with Article 263 of the Delegated Acts:

- 1) Deferred tax assets of £14m; this has been valued in line with IFRS, adjusted for the tax impact of temporary differences including goodwill, intangible assets and reserves as valued under Solvency II regulations. The value of the deferred tax asset arising was validated based on Board approved plan future taxable profit projections. The profits used will not include any reversal of the risk margin.
- 2) Reinsurance recoverables from Non-Life excluding Health £281m; this has been valued using the cash flow projection method, in a consistent manner with the calculation of the best estimate liabilities and adjusted for expected losses due to the default of reinsurance counterparties. Further information regarding the best estimate liabilities can be found earlier in Section D.
- 3) Receivables (trade, not insurance) of £49m and any other Assets, not elsewhere shown of £26m are valued consistently with IFRS. Management believe this to be representative of the fair value at the reporting date.

The following material liabilities have been valued using alternative valuation methods in accordance with Article 263 of the Delegated Acts:

- 1) Best Estimate Liability and Risk Margin £1,434m; this has been valued under Solvency II methodologies and further information can be found earlier in this report.
- 2) Derivatives £15m; this has been valued consistently with IFRS using mark to model valuation as detailed below :

Description	Fair value	Valuation technique	Unobservable inputs	Range of unobservable inputs (probability weighted average)	Relationship of unobservable inputs to fair value
Derivative liability	15	Mark-to-model	Gilt repo rates	The range on market gilt repo rates offered can be up to 10 bps	A gilt repo rate increase will result in a lower contract value

- 3) Payables (trade, not insurance) £49m; trade payables are initially valued consistently with IFRS. The MIB levy is then removed from the payable balance and included within the Best Estimate Liability calculations. For further information on this calculation can be found earlier in this report.

D.5 Any other information

The bases, methods and main assumptions used at a group level for the valuation of solvency purposes of the group's assets, technical provisions and other liabilities does not differ materially from those used by LVIC.

E. Capital Management (LVIC)

E.1 Own funds

The key capital management policies and objectives for LVIC are set at Group level and consistent across all entities. The approach to measuring and monitoring capital for LVIC is defined and actioned at Group. In addition the Group backs all the underlying entities and has in place mechanisms to support these capital positions if necessary

For further information on these please see section E.1a and E.1b of the Group section of this report.

The following table details the structure, amount and quality of basic own funds and ancillary own funds.

	Tier 1 £m	Tier 2 £m	Tier 3 £m	Total £m
Ordinary share capital (gross of own shares)	345	-	-	345
Initial funds / members contributions	137	-	-	137
Reconciliation reserve	(36)	-	-	(36)
Subordinated liabilities	-	-	-	-
An amount equal to the value of net deferred tax assets	-	-	14	14
Total Basic Own Funds	446	-	14	460
Total available Own Funds to meet the SCR	446	-	14	460
Total available Own Funds to meet the MCR	446	-	14	446

The following tables detail the eligibility of own funds to meet the SCR and MCR.

Total available Own Funds to meet the SCR	446	-	14	460
Total eligible Own Funds to meet the SCR	446	-	14	460
Total available Own Funds to meet the MCR	446	-	14	446
Total eligible Own Funds to meet the MCR	446	-	14	446

Tier 1 consists of both Ordinary Shares £345m and Initial Funds being a capital injection of £137m, both of which carry no requirement for LVIC to repay. Capital given is a permanent contribution, with no payback terms and carries no interest or charges.

Tier 3 relates to deferred tax assets of £14m which is valued in accordance with IFRS and has no terms and conditions attached.

A dividend of £3.4m (£0.01 per share) on preference shares was declared by the Directors following year end 2015 and remitted to the parent company in January 2016.

Analysis of significant changes in own funds during the reporting period

	LVIC		
	Day 1 2016 £m	Movement £m	Annual 2016 £m
Eligible own funds			
Tier 1 capital	501	-55	446
Tier 3 capital	9	4	14
Total capital	510	-50	460
Made up by:			
Equity shares	345	-	345
<i>Initial funds / members' contribution</i>	<i>141</i>	<i>-3</i>	<i>137</i>
Deferred tax	9	5	14
Reconciliation reserve / surplus	15	-52	-36
Total capital	510	-50	460
Total eligible own funds to meet SCR	510	-50	460

Tier 1 capital includes movements in excess of assets over liabilities, adjusted for the movement in deferred tax. The reduction of £50m since the start of the year has predominately been driven by the impact of Ogden:

- Tier 3 capital represents the deferred tax asset.
- The fall in in initial funds / members' contributions is due to a dividend payment of £3.4m

Ancillary own funds

At 31st December 2016 there are no ancillary own funds.

Deductions from own funds

At 31st December 2016 there are no deductions from own funds

Explanation of the key elements of the reconciliation reserve

Reconciliation reserve	£m
Retained earnings on a Solvency II basis	(36)
Total	(36)

LVIC has not applied loss absorbency mechanisms as at the end of 2016.

Material Differences between equity as shown in the undertaking's financial statements and the excess of assets over liabilities as calculated for solvency purposes

The following table provides a reconciliation of equity (unallocated divisible surplus) under IFRS to Solvency II excess of assets over liabilities.

	£m
Analysis of Equity - IFRS	
Ordinary shares, allotted and fully paid	345
Capital reserve	137
Retained Earnings	135
Total Equity - IFRS	617
Solvency II Adjustments (excluding reclassifications)	
<u>Assets</u>	
- Reduction in valuation of goodwill (Section D1 note 1)	(16)
- Reduction in valuation of DAC (Section D1 note 2)	(74)
- Reduction in valuation of intangibles	(2)
- reduction in participations	(93)
- Reduction in valuation of reinsurance recoverable (Section D1 note 6)	(21)
- Reduction in valuation of insurance and intermediaries recoverable (Section D1 note 7)	(233)
- Deferred Tax Assets	14
- Other	
	(425)
<u>Technical provisions</u>	
- Increase in valuation of technical provisions (Section D2)	239
<u>Other liabilities</u>	
- Reduction in deferred tax liabilities	1
- Reduction in payables	28
	29
Total Equity - solvency basis	460
Total own funds – solvency basis	460

Excess of Assets over Liabilities - solvency basis	
Total Assets	1,960
Total Technical Provisions	(1,434)
Total Other Liabilities	(66)
Excess of Assets over Liabilities - solvency basis	460

Differences in the asset and liability valuation methodology used for solvency purposes and that used under IFRS are set out in Section D.

Own-fund item that is subject to the transitional arrangements

LVIC has no own funds subject to transitional measures

E.2 SCR and MCR

E.2.1 SCR and MCR

The following table shows the amount of the LVIC SCR and MCR.

	£m
LVIC SCR	427
LVIC MCR	177

The LVIC SCR increased by approximately £30m over the reporting period largely due to the reduction in the Ogden discount rate and reduction in tax relief following this, and business planning changes, with some offset due to changes in risk mitigating techniques.

The Minimum Capital Requirement (MCR) as at 31st December 2016 was £177m. The calculation of the MCR is laid out in the S.28.01.01 QRT included with this report. The MCR is determined using a calculation, as specified in the Solvency II regulations, involving the technical provision, capital at risk and SCR, subject to a floor specified in Euros and converted to pounds sterling. The MCR increased over the period in line with the SCR.

E.2.2 Basis of calculation

LVIC uses a Standard Formula basis to calculate the SCR. The approach to calculating the SCR and MCR is in accordance with the Solvency II Directive. LVIC is not using any material simplifications or undertaking specific parameters in the calculation of the SCR and does not have any regulatory capital add-ons.

E.2.3 SCR split by risk

The following table summarises the risk modules which contribute to the Solvency Capital Requirement applicable under standard formula. The figures are presented net of loss absorbing capacity of Technical Provisions with LACDT shown separately.

LVIC Year end 2016 - all figures in £m	
Non-life underwriting risk	347
Market risk	90
Counterparty default risk	14
Life underwriting risk	2
Diversification	(66)
Basic solvency capital requirement	387
Operational risk	40
Loss-absorbing capacity of technical provisions	0
Loss-absorbing capacity of deferred taxes	0
Solvency capital requirement	427

E.3 Use of a duration-based equity risk sub-module

LVIC has not applied the duration-based equity risk sub-module in the calculation of the SCR.

E.4 Differences between Standard Formula and any Internal Model used

This does not apply as LVIC does not currently use an Internal Model to calculate its SCR.

E.5 Non-compliance with the MCR and the SCR

LVIC has been compliant with the MCR and SCR throughout the reporting period.

E.6 Any other material information

There is no other additional information.

HIGHWAY SFCR

A. Business and Performance (Highway)

A.1 Business

a) Name and legal form of undertaking

Highway Insurance Company Limited is a UK-incorporated and domiciled company limited by shares.

For the contact details of Highway please see part a) in chapter A1 of the Group section of this report.

b) Name and contact detail of the supervisory authority responsible for financial supervision.

Firm's reference number: 202972

The Prudential Regulation Authority is responsible for the financial supervision of the company.

For the contact details of the PRA please see part b) in chapter A1 of the Group section of this report.

c) Name and contact details of the external auditor

For information on the external auditor of Highway please see part c) in chapter A1 of the Group section of this report.

d) Description of the holders of qualifying holdings in the undertaking

For a description of 'qualifying holdings' please see part d) in chapter A1 of the Group section of this report.

Highway is a wholly owned indirect subsidiary of LVFS.

For an illustration of the qualifying holdings up to LVFS please see part e) in chapter A1 of the Group section of this report.

e) Details of the undertakings within the group

For an explanation of the undertakings position within the group please see part e) in chapter A1 of the Group section of this report.

f) Material lines of business and material geographic areas.

Materially Highway underwrites non-life insurance contracts within the UK.

Highway conducts general insurance business through broker distribution channels. The primary sources of premium income are from the sale of Motor insurance products. Motor insurance products include Private Car, Specialist Car, Fleet, Motorcycle and Commercial Vehicles

As such the following Solvency II non-life lines of business are written on either a standalone or bundled product basis:

- Motor vehicle liability insurance
- Other motor insurance
- Fire and other damage to property insurance
- General liability insurance

g) Significant business or other events occurring during the reporting period that have a material impact on the undertaking.

Solvency and Financial Condition

Highway's capital position was impacted at the 2016 year end by the impact of the changes in the Ogden discount rate from 2.5% to minus 0.75% effective 20 March 2017 and recognised in the 2016 year end trading results and capital position.

The capital surplus as at 31st December 2016 after the impact of Ogden under the Standard Formula stood at £82m with capital cover of 151%.

Business and Performance

The profit before tax before the impact of the Ogden discount rate change, was £27 million, a big increase compared to 2015. This reflects strong investment returns and a strong increase in the underwriting result. In March 2017 the Ogden discount rate dropped from 2.5% to -0.75%, and the result of this was to increase our 2016 claims figure by £49 million. The 2016 results for the Company after the impact of the Ogden rate change show a loss before taxation of £18 million (2015: profit £3 million).

Highway P&L (£m)	2016	2015
Net earned premiums	272	239
Net claims incurred	(219)	(145)
Expenses incurred	(87)	(99)
Net underwriting result	(34)	(5)
Net investment income	16	8
Other	0	0
Net profit / (loss) before tax	(18)	3
Tax	4	0
Net profit / (loss) after tax	(14)	3

All income statement numbers presented in Section A are based on the IFRS Financial Statements adjusted for certain presentational adjustments made in the QRTs. Profit before tax is the same under both presentations.

System of Governance

There have been no significant changes in Highway's system of governance in the year. The table below summarises the changes in membership of the Board in the year:

P M Bunker - Resigned 1st January 2016	M P Crane - Appointed 1st January 2016
S V Castle - Resigned 19th September 2016	C Burton - Appointed 1st October 2016
S R Haynes - Resigned 1st October 2016	D Neave - Appointed 16th December 2016
J M Laidlaw - Resigned 1st October 2016	K O'Keefe - Appointed 7th October 2016
J B O'Roarke - Resigned 28th May 2016	S Treloar - Appointed 5th May 2016
M J Rogers - Resigned 28th July 2016	
R A Warner - Resigned 1st October 2016	

A.2 Underwriting performance

All business is underwritten in the UK and the following provides an analysis of the underwriting income and expenses for 2016 in addition to a comparative for 2015.

2016	Motor vehicle liability insurance	Other motor insurance	Fire and other damage to property insurance	General liability insurance	Other	Total
	£m	£m	£m	£m	£m	£m
Net earned premiums	216	51	3	2		272
Net claims incurred	(174)	(41)	(2)	(2)		(219)
Expenses incurred (excluding	(68)	(16)	(1)	(1)	(1)	(87)
Net total	(26)	(6)	0	(1)	(1)	(34)
Claims ratio	80.6%	80.4%	66.7%	100.0%		80.5%
Expense ratio	31.5%	31.4%	33.3%	50.0%		32.0%
Combined ratio	112.0%	111.8%	100.0%	150.0%		112.5%

2015	Motor vehicle liability insurance	Other motor insurance	Fire and other damage to property insurance	General liability insurance	Other	Total
	£m	£m	£m	£m	£m	£m
Net earned premiums	189	45	3	2		239
Net claims incurred	(115)	(27)	(2)	(1)		(145)
Expenses incurred (excluding	(78)	(19)	(1)	(1)	0	(99)
Net total	(4)	(1)	0	0	0	(5)
Claims ratio	60.8%	60.0%	66.7%	50.0%		60.7%
Expense ratio	41.3%	42.2%	33.3%	50.0%		41.4%
Combined ratio	102.1%	102.2%	100.0%	100.0%		102.1%

The ratios have been calculated as follows:-

- Claims ratio = Net claims incurred ÷ Net earned premiums
- Expense ratio = Expenses incurred ÷ Net earned premiums
- Combined ratio = (Net claims incurred + Expenses incurred) ÷ Net earned premiums

Market conditions have remained competitive, particularly in Motor. The Motor market in general is now supporting price increases so volumes are continuing to remain stable. Highway has therefore been able to hold its competitive position and underwriting margins.

The Ogden rate was reduced in early 2017 from 2.5% to -0.75% which directly impacted the cost of claims and has seen the Highway's result before tax move from a £27 million profit, to an £18 million loss. During 2016 Highway continued to develop its products and enhance its pricing and underwriting processes, in order to improve the claims performance.

In response to the competitive market conditions Highway has maintained strong cost disciplines through controlling acquisition costs and operating expenses during the year. Nevertheless, investment in staff, systems, marketing and infrastructure has continued to ensure that it is well placed to deliver its profitable growth strategy.

Highway's underwriting profit was initially strong during 2016 however the change in the Ogden rate has greatly impacted the result, delivering a combined ratio of 112.3% (2015: 101.7%). The reserves have been strengthened by £49 million to account for the movement in the Ogden discount rate. The high level of reserve run-off seen during 2015 was mostly due to favourable claims experience of development trends. This was an exceptional set of circumstances which wasn't repeated in 2016.

A.3 Investment performance

The following table summarises the income and expenses with respect to investment activities during the last reporting period together with a comparison of the information with that reported on the previous reporting period:

	2016 £m	2015 £m
Dividend income	3	3
Interest income	16	21
Realised and unrealised gains/(losses)	(2)	(15)
Investment expenses	(1)	(1)
Total Investment Performance	16	8

Investment returns were positive over 2016 due to the strong performance from equities and credit bonds. The continued low underlying interest rate market resulted in low income returns but this was offset by higher capital returns in Equities and Corporate bonds.

Investment returns by asset class for 2016 and 2015 are detailed below:

2016 Asset class (£m)	Dividends	Interest	Realised / Unrealised gains / losses	Total	Average investment holding during 2016	Average investment return
Government bonds	-	2.6	-	2.6	122.0	2.13%
Corporate bonds	-	13.0	(4.2)	8.8	318.5	2.76%
Equity	-	-	-	0.0	0.0	N/A
Collective investment undertakings	3.4	-	8.5	11.9	157.5	7.56%
Collateralised securities	-	0.2	(0.1)	0.1	3.0	3.33%
Cash and deposits	-	0.1	1.1	1.2	132.5	0.91%
Put Options / Swaps / Futures /	-	-	(8.0)	(8.0)	0.3	N/A
Total	3.4	15.9	(2.7)	16.6		
Less investment expenses				(0.8)		
Net total				15.8		

2015 Asset class (£m)	Dividends	Interest	Realised / Unrealised gains / losses	Total	Average investment holding during 2015	Average investment return
Government bonds	-	5.0	(3.6)	1.4	136.0	1.03%
Corporate bonds	-	15.3	(10.8)	4.5	293.0	1.54%
Equity	2.6	-	-	2.6	0.0	N/A
Collective investment undertakings	-	-	1.3	1.3	117.0	1.11%
Collateralised securities	-	0.3	(0.1)	0.2	13.5	1.48%
Cash and deposits	-	0.2	0.1	0.3	183.5	0.16%
Put Options / Swaps / Futures / Forwards	-	-	(1.2)	(1.2)	0.4	N/A
Total	2.6	20.8	(14.3)	9.1		
Less investment expenses				(1.3)		
Net total				7.8		

A.4 Performance of other activities

The following items have been identified as material income and expenses, other than underwriting or investment income and expenses over the reporting period:

	2016 £m	2015 £m
Other income	0.5	0.6
Subordinated debt charges	(0.4)	(0.3)
Tax charges	4.0	(0.2)
Total	4.1	0.1

Other income predominantly represents profit share relating to the quota share arrangement. Whilst Highway cedes 20% of the business to the reinsurer, the maximum margin available to them is 1.75% with any surplus returned to Highway as profit share on commutation.

Highway issued subordinated debt of Eur12m in December 2004 and this has an original maturity date of November 2034. Accordingly, the projected finance charges linked to this debt have been included in the table above.

The tax charge is calculated based on the IFRS Profits and Losses reflecting the underwriting performance, investment performance and charges related to subordinated debt. In addition, deferred tax assets can be recognised relating to capital allowances in excess of depreciation and any tax losses carried forward. Where a tax loss arises (as in 2016 due to the impact of Ogden) Board Approved Business Plans are required to evidence and support the future recovery of the Deferred Tax Asset by the utilisation of future available taxable profits.

A.5 Any other information

There is no additional information to disclose for section A.

B. System of Governance (Highway)

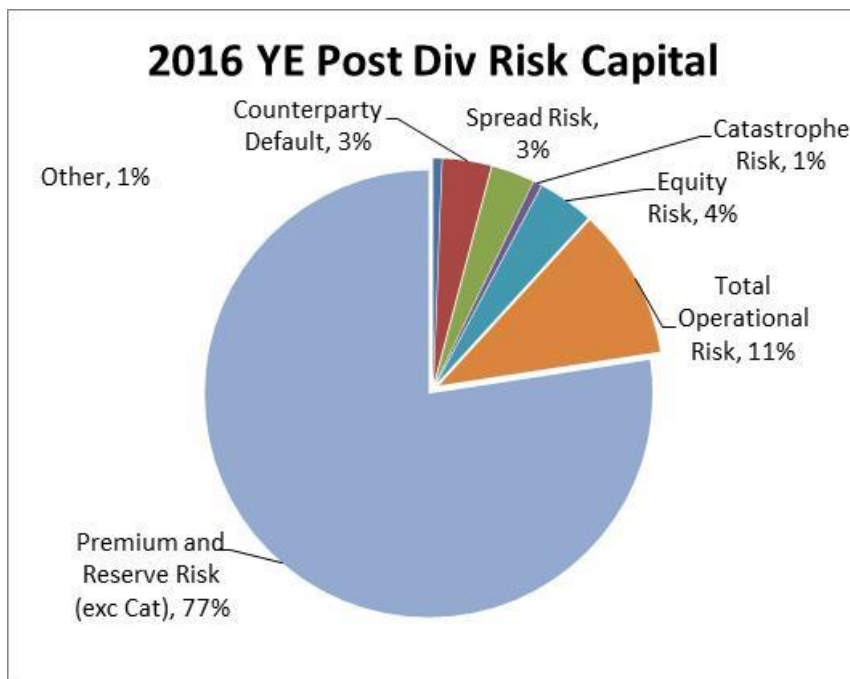
The system of governance for Highway is described in Section B of the Group section of this report.

C. Risk Profile (Highway)

C1. Overview

C.1.1 Overview of risk exposures

The chart below shows the year-end 2016 split of the Standard Formula Solvency Capital Requirement (SCR) by risk type. The largest exposure relates to Underwriting Risk with 77% followed by Operational Risk with 11%.



C.1.2 Measurement of risk exposures

A group wide approach is taken in measuring risk exposures. This is described within the main LVFS Group SFCR in section C1.2.

C.1.3 Prudent person principle

A common investment framework is employed across the LVFS Group and its subsidiaries. This is set out within the main LVFS Group SFCR in section C1.3.

C.1.4 Risk concentration

This is described within the main LVFS Group SFCR in section C1.4, with no significant additional risk concentrations at the Highway entity level.

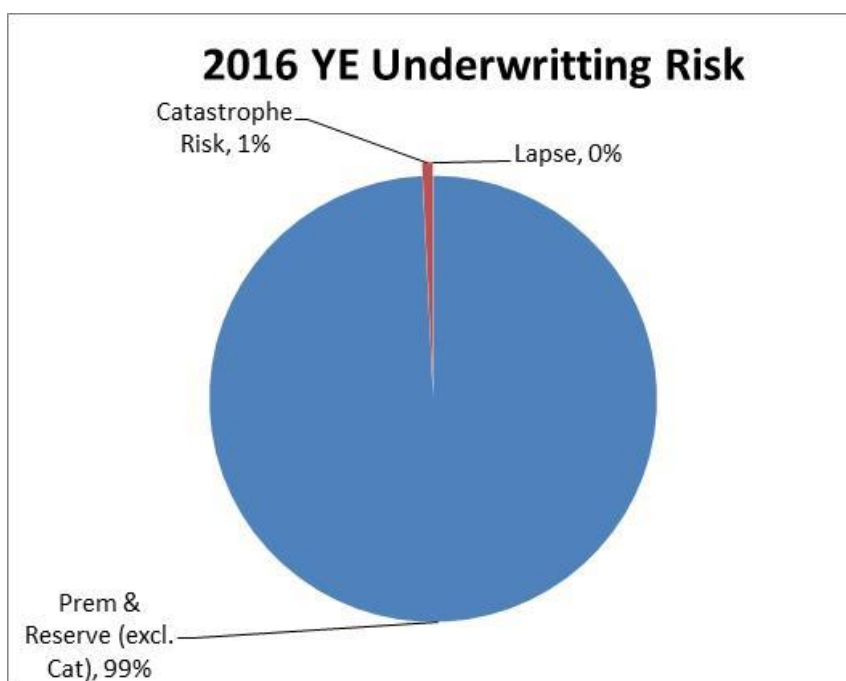
C.2 Underwriting risk

C.2.1 Underwriting risk exposure

These are described within the main LVFS Group SFCR in section C2.1.

Highway's Underwriting Risk is primarily driven by the uncertainty in the amount of claims and expenses it incurs from both expired risk and unexpired risk and in relation to the level of premiums to be written on future new business. This is captured within the Premium and Reserve Risk component which dominates Underwriting Risk. Highway, as a predominantly motor writer, has negligible Catastrophe Risk.

Lapse Risk is modelled explicitly within the Standard Formula and is the risk that profitable policies lapse over the one-year time horizon. Within the Internal Model, this risk is captured within Premium Risk.



C.2.2 Material changes over the reporting period

The change to the Ogden discount rate detailed in the LVFS Group SFCR, section C2.2, was the most significant change experienced by Highway during the period.

C.2.3 Risk mitigation techniques

Reinsurance purchase is the main tool used to keep underwriting exposure within risk appetite. This is discussed in section C2.3 of the LVFS Group SFCR.

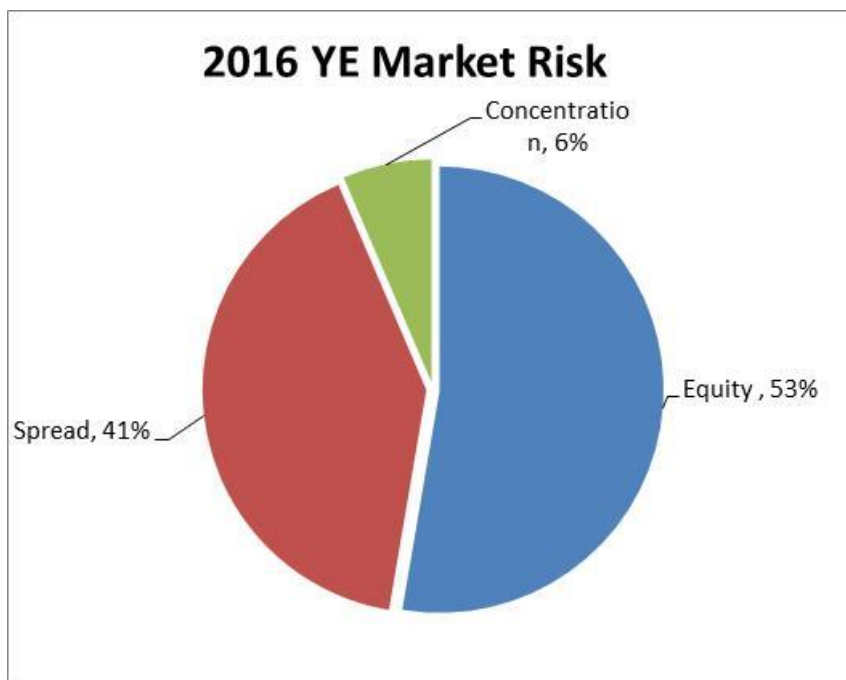
A range of reinsurance contracts are entered into, typically annually across the motor business to mitigate the risk of large losses. In addition, Loss Portfolio Transfer and Whole Account Quota Share programmes have been entered into to cede a portion of risk out of the entity.

C.3 Market risk

C.3.1 Market risk exposure

Market risk is managed at the Group level and the specific risk exposures are described further in section C3.1 of the main LVFS Group SFCR.

Within market risk the largest exposure is to Equity Risk which comprises 53% of the SCR post-diversification. Spread Risk is the next largest exposure at 23%, with LVIC having a relatively large exposure to corporate bonds.



C.3.2 Material changes over the reporting period

Interest rate Risk has reduced due to the implementation of hedging strategies and a reduction in Periodic Payment Order (PPO) liabilities, which are longer term than typical General Insurance liabilities, following the reduction in the Ogden discount rate.

C.3.3 Risk mitigation techniques

This is discussed in the LVFS Group SFCR, Section C3.3.

C.3.4 Risk concentrations

This is discussed in the LVFS Group SFCR, Section C3.4.

C.4 Credit counterparty risk

This is discussed in the LVFS Group SFCR, Section C4.

Highway has exposure to a single AA-rated reinsurer following a Loss Portfolio Transfer (LPT) and Whole Account Quota Share (QS) arrangement where a portion of risk was ceded away.

C.5 Other material risks

Liquidity, operational and other risks are managed at a LVFS Group level and are described further in section C5, C6 and C7 of the LVFS Group SFCR.

C.6 Sensitivities

This is discussed in the LVIC SFCR, Section C6, with the sensitivities broadly in line with those for LVIC. Note that the impact of Catastrophe Risk is negligible for Highway due to minimal exposure to this risk.

D. Valuation for Solvency Purposes (Highway)

D.1 Assets

For Solvency II valuation purposes, assets and liabilities are valued consistently with IFRS provided that IFRS valuation methods are consistent with Article 75 of Directive 2009/138. Assets and liabilities represent the fair value amount for which they could be exchanged between knowledgeable willing parties in an arm's length transaction.

The financial statements of the undertaking have been prepared in accordance with:

- International Financial Reporting Standards (IFRS), as endorsed by the European Union ('EU')
- International Financial Reporting Interpretations Committee ('IFRIC')
- Statement of Recommended Practice issued by the Association of British Insurers (2005), amended 2006 and
- those parts of the Companies Act 2006 applicable to companies reporting under IFRS.

	Note	2016			
		IFRS	Presentational adjustment	Solvency valuation adjustment	Solvency
		£m	£m	£m	£m
Deferred acquisition costs	1	28	-	(28)	-
Deferred tax assets	2	4	-	8	12
Investments (other than assets held for index-linked and unit-linked funds)	#	-	-	-	-
- Bonds	3	381	157	-	538
- Collective Investment undertakings	3	161	-	-	161
- Deposits other than cash equivalents	3	75	(56)	-	18
Reinsurance recoverables	4	187	-	39	226
Insurance and intermediaries receivables	5	40	-	(40)	-
Reinsurance receivables	#	4	-	(4)	-
Receivables (trade, not insurance)	#	-	-	1	1
Cash and cash equivalents	6	105	(93)	-	12
Any other assets, not elsewhere shown	7	9	(8)	-	1
Total Assets		994	-	(24)	969

#- Disclosure note not provided as solvency value equal to IFRS or the amounts are immaterial.

Notes

1. Deferred acquisition costs

For Solvency II valuation purposes, deferred acquisition costs are set to nil however the cashflows relating to DAC-able expenses, are included within the Technical Provisions valuation if they fall within the projected timeframes.

2. Deferred tax assets

Under IFRS, deferred tax assets relate to capital allowances in excess of depreciation and tax losses carried forward for offset against future profits. Board approved business plans support the future recoverability of the deferred tax asset by the utilization of future available taxable profits.

	£m
Deferred tax assets - IFRS	4
Solvency II Valuation Adjustment	8
Deferred tax assets - solvency valuation	12

There are a number of changes that need to be made to the IFRS Balance Sheet on the move to Solvency II which impact the Solvency II profit and the Deferred Tax provision established to recognise the timing differences arising. These relate to the changes in the valuation of intangible assets, reserves, insurance recoveries and payables and the value of subordinated sub debt.

The impact of these changes at 31.12.16 is a decrease in taxable profits of £44m. The recoverability of the losses arising from a move to Solvency II Base together with the losses arising in the IFRS accounts has been justified based on Board Approved Business Plans. These profits demonstrate that the timing differences arising from IFRS accounting and tax treatment plus the timing differences arising from the move to Solvency II results are fully covered and utilised by future taxable profits at the prevailing CT rates at times of recovery. The future profits projections utilised ensure that profits cannot be inadvertently counted twice. The reversal of the risk margin is not included in the profit projections.

The total taxable loss of £66m (i.e. IFRS £22m, plus Solvency II of £44m) has been justified based on the Board Approved Business Plans over the period 2017 to 2020. The DTA established over this period is based on the announced Corporation Tax rates, as follows.

Year	Loss Utilised (£m)	CT Rate	DTA (£m)
2017	8.5	19.25%	1.6
2018	13.7	19.00%	2.6
2019	21.6	19.00%	4.0
2020	22.2	17.25%	3.8
Total	66.0		12.0

3. Bonds, Investment Funds, Deposits other than cash equivalents

For solvency valuation purposes, financial assets are valued consistently with IFRS. However there are also there are mapping differences between the IFRS and Solvency II hierarchies which certain assets such as Collective Investment Undertakings are presented differently under IFRS.

Under IFRS, financial assets are valued at fair value through which income has two sub categories:

- Financial assets held for trading; and
- Those designated at fair value through income at inception.

Derivatives are classified at fair value through income as they are held for trading. Financial assets designated at fair value through income at inception are measured at market prices, or prices consistent with market ratings should no price be available. Day one gains are recognised only where valuations use data from observable markets. Any unrealised or realised gains or losses are taken to the Statement of Comprehensive Income, as fair value gains or losses, or realised gains or losses respectively, as they occur.

Financial assets at fair value through income; further information is provided in the table below.

Fair value estimation

For solvency valuation purposes, the fair value measurement hierarchy is as follows:

- Quoted market prices in active markets for same assets and liabilities (QMP). This is the default valuation method and is broadly consistent with Level 1 category assets under IFRS.
- Quoted market price in active markets for similar assets (QMPS). Maximum use is made of relevant market inputs such as quoted prices for identical or similar assets in an inactive market, observable inputs other than quoted prices and market corroborated inputs derived from observable market data. This is broadly consistent with Level 2 category assets under IFRS.
- Other alternative valuation method (AVM). Unobservable inputs reflecting the assumptions market participants would use when pricing the asset or liability, including assumptions about the risk inherent in both the inputs and the valuation technique. The undertaking uses various valuation approaches, including market, income and cost approaches. This is broadly consistent with Level 3 category assets under IFRS.
- Adjusted Equity Method (AEM) for Participations

The following table presents the financial assets measured at fair value at 31st December 2016.

	QMP	QMPS	Total
	£m	£m	£m
Bonds	271	267	538
Collective Investments Undertakings	161	-	161
Deposits other than cash equivalents	18	-	18
Investments (other than assets held for index-linked and unit-linked funds)	450	267	717

4. Reinsurance recoverables

The undertaking cedes insurance risk in the normal course of businesses. Reinsurance assets represent balances recoverable from reinsurance companies.

For solvency valuation purposes, reinsurance recoverables are valued using the cash-flow projection method and in a consistent manner with the calculation of the best estimate liabilities (see Technical provisions information later in Section D).

In calculating reinsurance recoverables under Solvency II, adjustments are made for the time difference between recoveries and direct payments and also for expected losses due to the default of a counterparty. The adjustment is based on an assessment of the probability of default of the counterparty and the average loss resulting therefrom (loss-given-default).

Under IFRS, recoverable amounts are estimated in a manner consistent with the outstanding claims provision. Reinsurance premiums are recognised in the same period as the underlying contract that they relate to.

	£m
Reinsurers' share of claims liabilities	187
Total Reinsurance Recoverables - IFRS	187
Best estimate liability adjustments	39
Total reinsurance recoverables - solvency valuation	226

5. Insurance and intermediaries receivables

For solvency valuation purposes, any future premiums (included in insurance receivables) which fall due after the valuation date and any premium debts (included within intermediaries receivables), are subject to best estimate liability calculation of technical provisions (see D2. Technical Provisions). Under IFRS, insurance and intermediaries receivables are recognised when due and include amounts due from policy holders, agents, brokers and intermediaries. Insurance and intermediaries receivables are initially recognised at fair value and then subsequently held at amortised cost. Where there is objective evidence that the carrying value is impaired then the impairment loss will be recognised in the statement of comprehensive income.

	£m
Due from policyholders	-
Due from agents, brokers and intermediaries	40
Total Insurance and intermediaries receivables - IFRS	40
Best estimate liability adjustments	(40)
Total reinsurance recoverables – solvency valuation	-

6. Cash and cash equivalents

For solvency valuation purposes, cash is valued consistently with IFRS with a reclassification adjustment for short term bank deposits which are included in investments (other than assets held for index-linked and unit-linked funds) as deposits other than cash equivalents due to the CIC code assigned to them.

Under IFRS, cash and cash equivalents comprise cash at bank and in hand, and short-term deposits with an original maturity of three months or less. These are valued at fair value based on amounts receivable on demand.

	£m
Bank Balances	12
Short term bank deposits	93
Total cash and cash equivalents - IFRS	105
Reclassify short term deposits into bonds	(93)
Total cash and cash equivalents - solvency valuation	12

7. Any other assets, not elsewhere shown

For solvency valuation purposes, prepayments and accrued income are valued consistently with IFRS. On the Solvency II balance sheet, the accrued interest on bonds is included in the market value of Investments.

Under IFRS, prepayments and accrued income balances are all due within one year. These are valued at fair value based on amounts receivable on demand.

	£m
Accrued interest	7
Other prepayments and accrued income	1
Corporation tax asset	1
Prepayments and accrued income - IFRS	9
Reclassify accrued interest to Investments (excluding than assets held for index-linked and unit-linked funds)	(8)
Total any other assets, not elsewhere shown - solvency valuation	1

D.2 Technical provisions

The technical provisions are calculated as the sum of the claims provisions, premium provisions and the risk margin. The table below summarises the technical provision recorded as at year end 2016:

HICO (€ms)	Total	Motor Liability	Motor Other	Property Damage	General Liability	Legal Expenses	Assistance	Life excl Health
Gross Claims Provision	551	438	3	3	1	0	0	107
Gross Premium Provision	117	90	26	1	0	0	0	0
Gross BEL	668	527	29	4	1	0	0	107
Risk Margin	29	19	0	0	0	0	0	9
Technical Provisions	697	547	29	4	1	0	0	116

The 'Life Excl Health' Line of Business relates purely to claims that have settled as a Periodic Payment Order (PPO) whereby the claimant is granted, in addition to a lump sum payment on settlement, a regular income for life to pay for future care costs and loss of earnings. Such payments are generally linked to an inflation index representing the expected increases in salaries for care workers.

Methods and main assumptions

The business estimates the technical provisions using a range of standard actuarial and statistical techniques. This includes, where appropriate, stochastic models.

For attritional claims, these methods rely primarily on the 'chain-ladder' methods which use historic claim development triangles to attempt to predict the future development of claims which are reported but not settled and claims that are yet to be reported. For more recent periods, trended methods are adopted.

For non-PPO large claims a separate stochastic method is adopted that assumes claims settle with a severity that is consistent with a standard statistical distribution. For large claims that are yet to be reported a similar stochastic model is used but which additionally allows for an assumed distribution of the frequency of claims to be reported that differs by reporting delay.

For PPO claims a cashflow model is used. The primary assumptions made relate to future wage inflation for care workers, investment returns (by which cashflows are discounted), base mortality of claimants and any expected reduction in life expectancy due to the severity of the injuries suffered by the claimant.

The premium provision is the discounted cashflow in respect of premium receivables, claims and expenses arising from incepted unearned and un-incepted business. The undiscounted cash-flows are calculated using a suite of assumptions and are grouped into the Solvency II Lines of Business. The unearned premium and un-incepted premium runs-off over the subsequent twelve months and is adjusted to allow for several factors affecting claims and expenses. The claims and expenses generated from the unexpired risk are calculated and a cashflow produced, in line with the methodology employed in the calculation of the Claim Provision and allows for both reinsurance and the reinsurer default risk. Discounting these cashflows by the Solvency II lines of business produces the Solvency II Premium Provision.

Expenses and other cashflows associated with the servicing of claims and policies are allowed for. As are events that are not in the data (ENIDs).

Future cashflows used for the calculation of the Solvency II technical provisions are derived from payment patterns consistent with the IFRS ABE. All cashflows under Solvency II are discounted using the risk-free rate as imposed by EIOPA.

Risk Margin

The risk margin is calculated as required by the Solvency II regulations. The RM Model has developed from that used for the 2009 CEIOPS QIS5 exercise. The main change made to these models to form the Solvency II RM Model was a move from the template provided by CEIOPS for the QIS5 exercise to facilitate the RM calculation to an in-house model, designed to allow for the internal model output as well as standard formula output.

Under QIS5 there were five options allowed for determining the projected SCR figures:

- 1 Make a full calculation of all future SCRs without using simplifications.
- 2 Approximate the individual risks or sub-risks within some or all modules and sub-modules to be used for the calculation of future SCRs.
- 3 Approximate the whole SCR for each future year, e.g. by using a proportional approach.
- 4 Estimate all future SCRs “at once”, e.g. by using an approximation based on the duration approach.
- 5 Approximate the risk margin by calculating it as a percentage of the best estimate.

We have adopted Option 1 for the Standard Formula Basis.

Uncertainty

Insurance is a business based around uncertainty. In calculating the technical provisions judgement is used in deciding appropriate models to use and in calibrating the models. As such, there is inherent uncertainty around the value of the technical provisions both in terms of the amount and timing of future cashflows. The ENIDS aims to capture this uncertainty.

ENIDS

The approach used to derive the ENIDS loading has considered a combination of the scenarios for the large claims and catastrophic events, and a mean load statistical approach for the attritional claims. The statistical approach for attritional claims builds on a presentation at the Reserving Seminar 2016 which provided an alternative approach to the Lloyd’s Truncated Statistical Distribution approach called the mean load approach. The data segmentation is by product and the loadings derived are split by product.

Differences in valuation methodologies

The Solvency II BEL is very much based upon the IFRS ABE. However, elements of the ABE which are required under IFRS are not required under Solvency II and vice versa. Broadly, these can be summarised as follows:

- Past Deferred Acquisition Costs are not included in the cashflow projections. However, the future DAC-able expenses in the unincorporated business are included.
- An explicit claims margin is inadmissible under Solvency II. However this is replaced by an allowance for Events Not In Data (ENIDS) which is calculated using standard actuarial techniques;
- Under IFRS where liabilities are discounted (only PPOs) the Group can make an appropriate assumption as to expected asset returns whereas under Solvency II all liabilities (PPOs and non-PPOs) must be discounted using the yield curve specific to the UK as set by EIOPA; and
- The UPR (net of DAC and Premium Receivables) under IFRS is inadmissible under Solvency II. However, this is replaced by the premium provision.

Recoverables from reinsurance contracts and special purpose vehicles

The business enters into a number of reinsurance contracts. Most materially this includes an excess of loss arrangement to cover liability-related exposure with a retention set in line with the Group risk appetite. At the 2015 year-end the Group also entered into a General Insurance portfolio-wide Loss Portfolio Transfer arrangement for accident years 2015 and prior inclusive. Simultaneously, the Group entered into a quota share arrangement for the 2016 accident which has been renewed on the same terms for the 2017 accident year.

At present, there are no special purposes vehicles in place for the Group’s reinsurance.

Material changes in the relevant assumptions made in the calculation of the technical provisions

The Solvency II BEL relies upon the calculation of the IFRS ABE for many of its assumptions. As such, many of the elements of assumptions are updated throughout the year in line with changes in the IFRS ABE. In particular:

- Cashflow patterns;
- Expenses; and
- Allowance for reinsurer counterparty default.

Premium provision assumptions are updated in line with the reforecasting of the business Plan throughout the year.

The methodology for calculation of the ENID has been significantly enhanced throughout the year and mostly follows the method presented at the IFOA Reserving Seminar in June 2016.

As of March 2017, the Ogden discount rate has been changed from +2.5% p.a. to -0.75% p.a. In the interim whilst the underlying claim systems were updated, an estimated impact was applied to the IFRS ABE as at the 2016 year-end allowing for the impact of the incurred, PPO propensity, incurred but not yet reported (IBNYR) and reinsurance. The method allowed for all the large claims, the claims mostly impacted by the change in Ogden Rate, to be recalculated on an individual claim by claim basis on the new rate and revised estimated reinsurance recoveries. The expected IBNR claims and assumed PPO propensity were also adjusted to reflect the new Ogden rate. Smaller claims which are not so materially impacted by the rate change were uplifted by an expected average increase for these type of claims. As such, this overlay does also add to the uncertainty around the technical provisions.

As the source claim systems are updated in April 2017 the estimate will be unwound and replaced with a final calculation which, in the absence of further changes to the rate through 2017, will be reflected in the 2017 year-end position.

D.3 Other liabilities

For Solvency valuation purposes, assets and liabilities are valued consistently with IFRS provided that IFRS valuation methods are consistent with Article 75 of Directive 2009/138. Assets and liabilities represent the fair value amount for which they could be exchanged between knowledgeable willing parties in an arm's length transaction.

The financial statements of the undertaking have been prepared in accordance with:

- International Financial Reporting Standards (IFRS), as endorsed by the European Union ('EU').
- International Financial Reporting Interpretations Committee ('IFRIC').
- Statement of Recommended Practice issued by the Association of British Insurers (2005), amended 2006.
- Those parts of the Companies Act 2006 applicable to companies reporting under IFRS.

	Note	2016			
		IFRS	Presentational adjustment	Solvency valuation adjustment	Solvency
		£m	£m	£m	£m
Derivatives	#	7	-	-	7
Reinsurance payables	1	7	-	(7)	-
Payables (trade, not insurance)	2	26	-	(4)	22
Subordinated liabilities	3	10	-	2	12
Any other liabilities, not elsewhere shown	#	-	-	(1)	(1)
Total Other Liabilities		50	-	(10)	40

#- Disclosure note not provided as solvency value equal to IFRS or the amounts are immaterial.

Supporting Notes

1. Reinsurance payables

For Solvency II valuation purposes, reinsurance payables are included within the BEL calculations.

Under IFRS, reinsurance payables are recognised when due. Where there is objective evidence that the carrying value is impaired then the impairment loss will be recognised in the statement of comprehensive income. Reinsurance payables are initially recognised at fair value and subsequently held at amortised cost.

	£m
Due to reinsurers	7
Total reinsurance payables - IFRS	7
Reinsurance payables included in BEL calculations	(7)
Total reinsurance payables solvency valuation	-

The maturity profile of the liability recognised in the financial statements is summarised in the following table:

	Within 1 year	1 - 3 years	3 - 5 years	Over 5 years	UL	£m
Insurance and intermediaries payables	7	-	-	-	-	7

2. Payables (trade, not insurance)

For solvency valuation purpose, trade payables are initially valued consistently with IFRS and then adjusted as part of the BEL calculations.

Under IFRS, trade payables are recognised when due. Where there is objective evidence that the carrying value is impaired then the impairment loss will be recognised in the statement of comprehensive income. Reinsurance payables are initially recognised at fair value and subsequently held at amortised cost.

	£m
Bank overdrafts	4
Amounts owed to group undertakings	5
Other taxes and social security costs	9
Other payables	1
Accruals and deferred income	7
Total Payables (trade, not insurance) - IFRS	26
Reclassification of payables included in BEL calculations	(4)
Payables (trade, not insurance) – solvency valuation	22

The maturity profile of the liability recognised in the financial statements is summarised in the following table:

	Within 1 year	1 - 3 years	3 - 5 years	Over 5 years	UL	£m
						Total
Payables (trade, not insurance) - excluding other tax and social security costs	17	-	-	-	-	17

3. Subordinated liabilities

€12m subordinated note is repayable in 2034. Interest is payable on the Notes at the 3 month euro deposit rate plus a margin of 365 basis points.

For solvency valuation purposes, the subordinated notes have been measured using the risk free rate at the valuation date, whilst keeping the spread versus risk free rate at point of issue constant, thus eliminating the effect of changes in credit rating. The model uses the discounted cashflow approach with the spread measured against the risk free rate to equate back to the amount of debt issued. It also allows for accrued interest at point of valuation. The debt is not callable and has a maturity date of 2034.

Under IFRS, subordinated liabilities are initially measured at the fair value of the proceeds less attributable transaction costs. Subsequent to initial recognition they are measured at amortised cost. The transaction costs are amortised over the period to the earliest possible redemption date on an effective interest rate basis. The amortisation charge is included in the Statement of Comprehensive Income within finance costs. An equivalent amount is added to the carrying value of the liability such that at the redemption date the value of the liability equals the redemption value.

Subordinated liabilities	£m
Subordinated notes (€ 12m)	10
Subordinated liabilities - IFRS	10
Revaluation of subordinated debt	2
Subordinated liabilities -solvency valuation	12

€12m subordinated note is repayable in 2034. Interest is payable on the Notes at the 3 month euro deposit rate plus a margin of 365 basis points.

D.4 Alternative methods for valuation

Information is provided for assets valued using alternative methods.

Justification for using alternative methods

The Group aims to use quoted market prices or observable inputs to value all assets and liabilities however where there is no external market or readily observable inputs, the Group will use an alternative method such as discounted cash-flow or mark-to-model.

Assumptions used in valuation approach and areas of uncertainty

Alternative methods for valuation include the use of estimates and assumptions that are not market observable but are based on a combination of internally developed models, calibrated to market observable data where possible as well as independent third-party evidence. Valuation uncertainty arises where there is reliance on third-party adherence to expected valuation standards or potential variation in the expected range of the key inputs into models.

The following material assets have been valued using alternative valuation methods in accordance with Article 263 of the Delegated Acts:

- 1) Deferred tax assets of £12m; this has been valued in line with IFRS, adjusted for the tax impact of temporary differences including goodwill, intangible assets and reserves as valued under Solvency II regulations. The value of the deferred tax asset arising was validated based on Board approved plan future taxable profit projections. The profits used will not include any reversal of the risk margin.
- 2) Reinsurance recoverables from Non-Life excluding Health £226m; this has been valued using the cash flow projection method, in a consistent manner with the calculation of the best estimate liabilities and adjusted for expected losses due to the default of reinsurance counterparties. Further information regarding the best estimate liabilities can be found earlier in Section D.

The following material liabilities have been valued using alternative valuation methods in accordance with Article 263 of the Delegated Acts:

- 4) Best Estimate Liability and Risk Margin £697m; this has been valued under Solvency II methodologies and further information can be found earlier in this report.
- 5) Payables (trade, not insurance) £22m; trade payables are initially valued consistently with IFRS. The MIB levy is then removed from the payable balance and included within the Best Estimate Liability calculations. For further information on this calculation can be found earlier in this report.

D.5 Any other information

The bases, methods and main assumptions used at a group level for the valuation of solvency purposes of the group's assets, technical provisions and other liabilities does not differ materially from those used by Highway.

E. Capital Management (Highway)

E.1 Own funds

The key capital management policies and objectives for Highway are set at Group level and consistent across all entities. The approach to measuring and monitoring capital for Highway is defined and actioned at Group. In addition the Group backs all the underlying entities and has in place mechanisms to support these capital positions if necessary

For further information on these please see section E.1a and E1b of the Group section of this report.

The following table details the structure, amount and quality of basic own funds and ancillary own funds.

	Tier 1 £m	Tier 2 £m	Tier 3 £m	Total £m
Ordinary share capital (gross of own shares)	75	-	-	75
Initial funds / members contributions	150	-	-	150
Reconciliation reserve	(6)	-	-	(6)
Subordinated liabilities	-	12	-	12
An amount equal to the value of net deferred tax assets	-	-	12	12
Total Basic Own Funds	219	12	12	243
Total Basic Own Funds after deductions	219	12	12	243

The following tables detail the eligibility of own funds to meet the SCR and MCR.

Total available Own Funds to meet the SCR	219	12	12	243
Total eligible Own Funds to meet the SCR	219	12	12	243

Total available Own Funds to meet the MCR	219	12	12	231
Total eligible Own Funds to meet the SCR	219	12	12	231

No own funds has been reported for the prior year as allowed by article 303 of the Delegated Regulations

Tier 1 consists of both Ordinary Shares £75m and Initial Funds being a capital injection of £150m, both of which carry no requirement for Highway to repay. Capital given is a permanent contribution, with no payback terms and carries no interest or charges.

Tier 2 consists of subordinated debt issued by Highway for EUR 12m. (See transitional arrangements below.)

Tier 3 relates to deferred tax assets of £12m which is valued in accordance with IFRS and has no terms and conditions attached.

There have been no distributions made to shareholders during the reporting period.

Analysis of significant changes in own funds during the reporting period

	Highway		
	Day 1 2016 £m	Movement £m	Annual 2016 £m
Eligible own funds			
Tier 1 capital	248	-29	219
Tier 2 capital	9	3	12
Tier 3 capital	5	7	12
Total capital	262	-19	243
Made up by:			
Equity shares	75	-	75
Initial funds / members' contribution	150	-	150
Subordinated liabilities	9	3	12
Deferred tax	5	7	12
Reconciliation reserve / surplus	23	-29	-6
Total capital	262	-19	243
Total eligible own funds to meet SCR	262	-19	243

- Tier 1 capital includes movements in excess of assets over liabilities, adjusted for the movement in deferred tax. Excess assets over liabilities have reduced by £19m over the reporting period predominantly due to the impact of Ogden
- Tier 2 capital represents the subordinated debt. As the subordinated debt is a loan in Euro's, the value has increased from Day 1 due to fall in the value of sterling exchange rate.
- Tier 3 capital represents the deferred tax asset.

Ancillary own funds

At 31st December 2016 there are no ancillary own funds.

Deductions from own funds

At 31st December 2016 there are no deductions from own funds

Explanation of the key elements of the reconciliation reserve

Reconciliation reserve	£m
Retained earnings on a Solvency II basis	(6)
Total	(6)

Highway has not applied any loss absorbency mechanisms as at the end of 2016.

Material differences between equity as shown in the undertaking's financial statements and the excess of assets over liabilities as calculated for solvency purposes

The following table provides a reconciliation of equity (unallocated divisible surplus) under IFRS to Solvency II excess of assets over liabilities.

	£m
Analysis of Equity - IFRS	
Ordinary shares, allotted and fully paid	75
Capital reserve	150
Retained Earnings	37
Total Equity - IFRS	262
Solvency II Adjustments (excluding reclassifications)	
<u>Assets</u>	
- Reduction in valuation of DAC (Section D1)	(28)
- Reduction in valuation of reinsurance recoverable (Section D1)	39
- Reduction in valuation of insurance and intermediaries recoverable (Section D1)	(43)
- Deferred Tax Assets	8
- Other	
	(24)
<u>Technical provisions</u>	
- Increase in valuation of technical provisions (Section D2)	(17)
<u>Other liabilities</u>	
- Increase in payables	11
- Other	(1)
	10
Total Equity - solvency basis	231
Restricted own fund items due to ring fencing	
Restricted own fund items due to subordinated liabilities	
Total own funds solvency basis	231

Excess of Assets over Liabilities solvency basis	
Total Assets	969
Total Technical Provisions	(698)
Total Other Liabilities	(40)
Excess of Assets over Liabilities solvency basis	231

Differences in the asset and liability valuation methodology used for solvency purposes and that used under IFRS are set out in Section D.

Under Solvency II requirements, subordinated liabilities are included as a reconciling item in the table above since they are treated as liabilities for IFRS but count towards own funds.

Own-fund item that is subject to the transitional arrangements

Tier 2 consists of subordinated debt issued by Highway for EUR 12m in December 2004 which has an original maturity date of November 2034 and has the following terms and conditions;

- Ranks after the claims of all policy holders and beneficiaries and non-subordinated creditors
- Does not include features to cause insolvency
- Is only repayable at the option of Highway
- Includes no incentives to repay or redeem
- Allows the suspension of repayment or redemption of the debt if it would otherwise fail to meet SCR/MCR
- Provides for the distribution to be mandatorily deferred where there was non-compliance with SCR/MCR or where the distribution would lead to such non-compliance
- It was free from encumbrances and was not connected with any other transaction

Under the Solvency II transitional rules, the Highway subordinated debt is included in the Tier 2 category of Basic Own Funds for 10 years from 1 January 2016.

E.2 SCR and MCR

E.2.1 SCR and MCR

The following table shows the amount of the Highway SCR and MCR.

	£m
Highway SCR	160
Highway MCR	62

The Highway SCR increased by approximately £12m over the reporting period largely due to the reduction in the Ogden discount rate and reduction in tax relief following this, and business planning changes.

The Minimum Capital Requirement (MCR) as at 31st December 2016 was £62m. The calculation of the MCR is laid out in the S.28.01.01 QRT included with this report. The MCR is determined using a calculation, as specified in the Solvency II regulations, involving the technical provision, capital at risk and SCR, subject to a floor specified in Euros and converted to pounds sterling. The MCR increased over the period in line with the SCR.

E.2.2 Basis of calculation

Highway uses a Standard Formula basis to calculate the SCR. The approach to calculating the SCR and MCR is in accordance with the Solvency II Directive. Highway is not using any material simplifications or undertaking specific parameters in the calculation of the SCR and does not have any regulatory capital add-ons.

E.2.3 SCR split by risk

The following table summarises the risk modules which contribute to the Solvency Capital Requirement applicable under standard formula. The figures are presented net of loss absorbing capacity of Technical Provisions with LACDT shown separately.

Highway Year end 2016 - all figures in £m	
Non-life underwriting risk	128
Market risk	28
Counterparty default risk	10
Life underwriting risk	2
Diversification	(25)
Basic solvency capital requirement	143
Operational risk	17
Loss-absorbing capacity of technical provisions	0
Loss-absorbing capacity of deferred taxes	0
Solvency capital requirement	160

E.3 Use of a duration-based equity risk sub-module

Highway has not applied the duration-based equity risk sub-module in the calculation of the SCR.

E.4 Differences between Standard Formula and any Internal Model used

This does not apply as Highway does not currently use an Internal Model to calculate its SCR.

E.5 Non-compliance with the MCR and the SCR

Highway has been compliant with the MCR and SCR throughout the reporting period.

E.6 Any other material information

There is no other additional information.

TAC SFCR

A. Business and Performance (TAC)

A.1 Business

a) Name and legal form of undertaking

Teachers Assurance Company Limited is a UK-incorporated and domiciled company limited by shares.

For the contact details of TAC please see part a) in chapter A1 of the Group section of this report.

b) Name and contact detail of the supervisory authority responsible for financial supervision.

Firm's reference number: 202569

The Prudential Regulation Authority is responsible for the financial supervision of the company.

For the contact details of the PRA please see part b) in chapter A1 of the Group section of this report.

c) Name and contact details of the external auditor

The independent auditors are PricewaterhouseCoopers LLP

Address: 3 Forbury Place
23 Forbury Road
Reading
Berkshire
RG1 3JH

d) Description of the holders of qualifying holdings in the undertaking

For a description of 'qualifying holdings' please see part d) in chapter A1 of the Group section of this report.

TAC is a wholly owned direct subsidiary of LVFS.

For an illustration of the qualifying holdings up to LVFS please see part e) in chapter A1 of the Group section of this report.

e) Details of the undertakings within the group

For an explanation of the undertakings position within the group please see part e) in chapter A1 of the Group section of this report.

f) Material lines of business and material geographic areas.

Materially TAC underwrites non-life insurance contracts within the UK.

General insurance:

The principal activity is to underwrite general insurance business through both direct and broker distribution channels. The primary sources of premium income are from the sale of Home products.

As such the following Solvency II non-life lines of business are written:

- Fire and other damage to property insurance

g) Significant business or other events occurring during the reporting period that have a material impact on the undertaking.

TAC's principal purpose is to carry on general insurance business. During the first half of 2016, the organisation continued to offer its household contents and building insurance product. Teachers Provident Society Limited (TPS, the parent company of TAC) transferred its engagements to Liverpool Victoria Friendly Society Limited (LVFS) under section 86 of the Friendly Societies Act 1992. The transfer took place with an effective date of 1st June 2016.

One month after the transfer was completed, TAC ceased writing new business. The household contents and business insurance products underwritten prior to this date remain in force and TAC continues to administer existing policies in force and any claims that occur on those policies. As these policies come up for renewal, policyholders are invited to renew their insurance cover with Liverpool Victoria Insurance Company Limited.

TAC's household contents and building insurance products provide insurance protection for a 12 month period so accordingly, there will be no active policies in force from 1st July 2017.

Whilst there have been numerous changes of Director during 2016, the governance of our business remained stable, and apart from the impact of the change in solvency regulations at the start of the year, the solvency position and overall strength of the business was consistent. The changes in Directors include:

D H Furniss - Resigned 1 st June 2016	R Rowney – Appointed 31 st August 2016
I P Blanchard - Resigned 1 st June 2016	S Treloar - Appointed 1 st June 2016
W Michie - Resigned 1 st June 2016	K O’Keeffe - Appointed 7 th October 2016
P W Moore – Appointed 1 st June 2016	M Rogers – Appointed 1 st June 2016, Resigned 22 nd August 2016

Whilst TAC ceased writing new business after the transfer to LVFS, the organisation incurred a small underwriting loss £21k. The majority of the organisations invested assets have been placed with collective investment undertakings. This has resulted in annualised investment returns of 11% for the year at £997k income on an investment holding of £8,910k.

TAC used the Standard Formula to calculate its capital requirements throughout 2016, and this is expected going forward.

LV= has regulatory approval for the submission of a Group ORSA report. This means that the outputs of the individual ORSAs conducted for each of the Insurance Entities, in addition to those of the LV= Group, must be documented within the Group ORSA Report. There were no specific recommendations in the ORSA relating to TAC.

A.2 Underwriting performance

All business is underwritten in the UK.

The following table shows the underwriting income and expenses.

2016	Fire and other damage to property insurance
	(£000)
Net earned premiums	2,906
Net claims incurred	(1,491)
Expenses incurred (excluding investment management expenses)	(1,436)
Net total	(21)

Claims ratio	51.3%
Expense ratio	49.4%
Combined ratio	100.7%

For simplicity, the ratios have been calculated as follows:-

- Claims ratio = Net claims incurred ÷ Net earned premiums
- Expense ratio = Expenses incurred ÷ Net earned premiums
- Combined ratio = (Net claims incurred + Expenses incurred) ÷ Net earned premiums

TAC stopped writing new business in June 2016. During 2016 TAC saw favourable claims performance which is expected to continue in 2017 as it services only its current policy holders. In response to the competitive market conditions TAC has maintained strong cost disciplines through controlling acquisition costs and operating expenses during the year. TAC had a strong underwriting result during 2016 delivering a combined ratio of 99.8%. Premium was only written in the first six months of 2016 and the strong result benefitted from positive claims experience during the year.

A.3 Investment performance

The following table summarises the income and expenses with respect to investment activities during the last reporting period:

	2016 (£000)
Dividend income	168
Interest income	26
Net realised/unrealised gains/(losses)	829
Net total	1,023

TAC had investments of £8,910,000 at 31st December 2016 with an annualised investment return of 11% showing a strong performance in what was for most a difficult year in the markets.

The following table summarises the undertaking's overall investment performance during the reporting period and also by relevant asset class:

2016 Asset class (£000)	Dividends	Interest	Realised / Unrealised gains / losses	Total	Percentage of total	Average investment holding during 2016	Average investment return
Collective investment undertakings	167.5	-	829.0	996.5	97.48%	4,455.1	22.37%
Cash and deposits	-	25.7	-	25.7	2.52%	2,061.4	1.25%
Total	167.5	25.7	829.0	1,022.2			

A.4 Performance of other activities

Tax charges are the only other material expense for TAC.:

	2016 (£000)
Tax charges	(167)
Total	(167)

There are no other material income and expense items included for this organisation

A.5 Any other information

There is no additional information to disclose for section A.

B. System of Governance (TAC)

The system of governance for TAC is described in Section B of the Group section of this report.

C. Risk Profile (TAC)

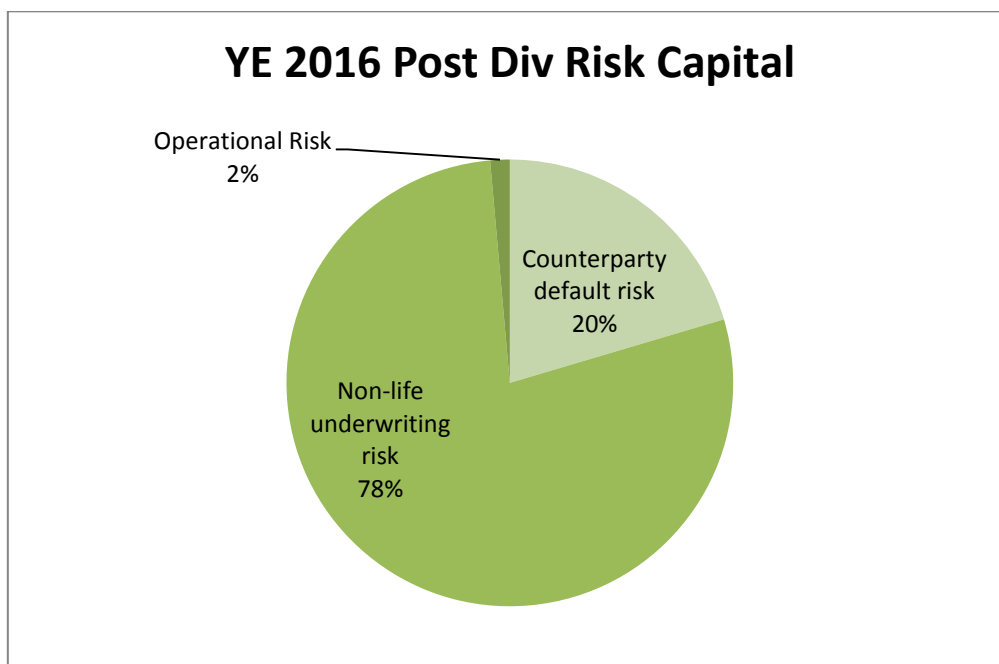
C.1 Overview

C.1.1 Overview of risk exposures

No new business has been written since June 2016 and policy holders have been able to renew their insurance with LVIC from July 2016. All policies are for 12 months so by July 2017 there should be no more policies in force.

TAC is exposed to weather catastrophe risk and credit counterparty risk. All risks are expected to decline in line with a fall in the investment portfolio as claims are settled and the book runs off.

During 2016 a number of reinsurance treaties were in place. No reinsurance is in place for 2017 and this is reflected in the capital calculations at YE 2016, which have been used to provide quantitative information on the risk profile.



C.1.2 Measurement of risk exposures

A group wide approach is taken in measuring risk exposures. This is described within the main LVFS Group SFCR in section C1.2.

C.1.3 Prudent person principle

A common investment framework is employed across the LVFS Group and its subsidiaries. This is set out within the main LVFS Group SFCR in section C1.3.

C.1.4 Risk concentration

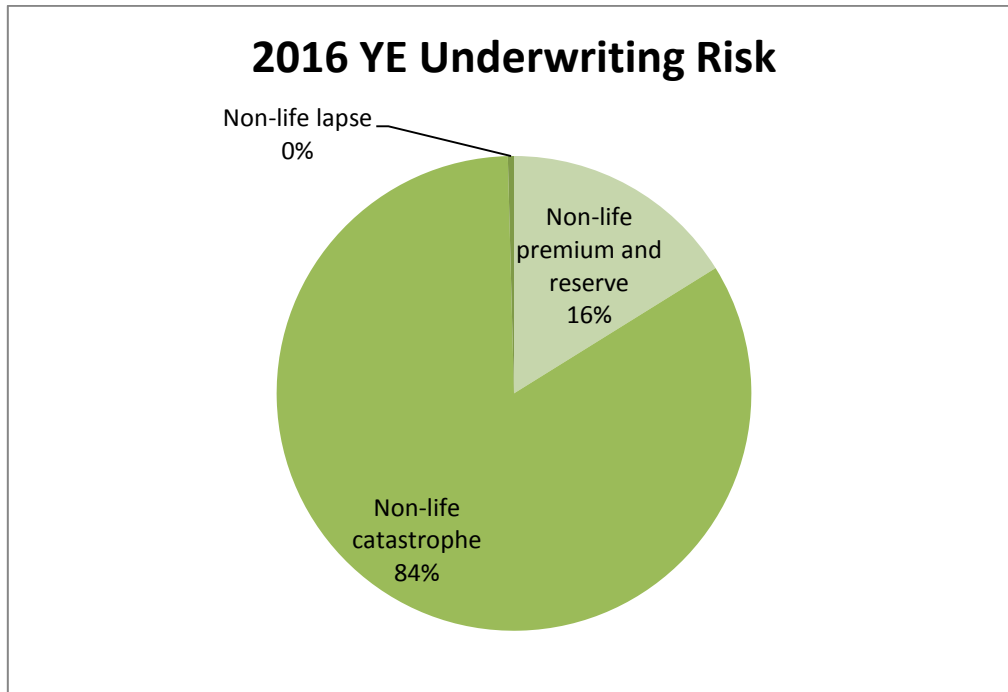
TAC is exposed to some concentration risk from the collective investment holding although this is with an approved financial institution.

C.2 Underwriting risk

C.2.1 Underwriting risk exposure

TAC is exposed to weather catastrophe risk and credit counterparty risk.

Catastrophe risk relates to the loss ratio for catastrophe claims differing from that expected as a consequence of either a difference in claims frequency or average claim cost, or a combination thereof. Various reinsurance treaties have been entered into over 2016 which mitigate against catastrophic events. No reinsurance is in place for 2017.



C.2.2 Material changes over the reporting period

TAC has seen an increase in underwriting risk due to the removal of reinsurance in the SCR calculation to reflect that no reinsurance cover is in place for 2017, this has been partially offset by the run-off of business.

C.2.3 Risk mitigation techniques

TAC undertakes reinsurance as a risk mitigation technique, which provides protection against catastrophic weather events to mitigate risks associated with Property business. No reinsurance is in place for claims occurring during 2017.

C.3 Market risk

C.3.1 Market risk exposure

Market risk is managed at the Group level and the specific risk exposures are described further in section C3.1 of the main LVFS Group SFCR.

TAC is not exposed to market risk.

C.3.2 Material changes over the reporting period

With the closure to new business in June and the renewal of all existing business into LVIC, TAC is now in run-off. Consequently, in line with the companies diminishing liabilities, all the assets of TAC were moved into highly liquid OEIC's (which are invested in cash and cash equivalents) or cash deposits to match projected underwriting future liabilities.

C.3.3 Risk mitigation techniques

As TAC is invested in cash or cash equivalent OEICs no risk mitigation techniques are required.

C.4 Credit counterparty risk

Credit Counterparty risk is described further section C4 of the main LVFS Group SFCR.

TAC is exposed to credit counterparty risk from:

- Reinsurer Default Risk could occur due to the failure of Reinsurer to pay monies owed.
- Budget Account / Premium Finance Default Risk might happen when customers fail to pay monies owed either.
- Asset Counterparty Risk might arise by third-party defaults and result in losses incurred on assets (including derivatives and bank deposits).
- Other counterparty risks could occur when losses are incurred where TAC prepays a third party to provide number of services, but the third party fails to provide these services. The risk is limited to financial implications as the failure to provide a services resulting in an operational impact is consider under the Operational Risk Section of this report.
- Concentration Risk might occur from a large exposure to a counterparty across different forms of exposure to them including various investment types, deposits and loans, and reinsurance.

All risks are expected to decline in line with a fall in the investment portfolio as claims are settled and the book runs off.

C.5 Other material risks

Liquidity, operational and other risks are managed at a LVFS Group level and are described further in section C5, C6 and C7 of the LVFS Group SFCR.

C.6 Sensitivities

No stress and scenario testing is conducted for TAC because of the limited risk exposures within the company.

D. Valuation for Solvency Purposes (TAC)

D.1 Assets

For solvency valuation purposes, assets and liabilities are valued consistently with IFRS provided that IFRS valuation methods are consistent with Article 75 of Directive 2009/138. Assets and liabilities represent the fair value amount for which they could be exchanged between knowledgeable willing parties in an arm's length transaction.

The financial statements of the undertaking have been prepared in accordance with:

- International Financial Reporting Standards (IFRS), as endorsed by the European Union ('EU')
- International Financial Reporting Interpretations Committee ('IFRIC')
- Statement of Recommended Practice issued by the Association of British Insurers (2005), amended 2006; and
- those parts of the Companies Act 2006 applicable to companies reporting under IFRS.

	Note	2016			
		IFRS	Presentational adjustment	Solvency valuation adjustment	Solvency II
		£000	£000	£000	£000
Deferred acquisition costs	1	52	-	(52)	-
Investments		-			-
- Investment funds	2	8,910	-	-	8,910
- Deposits other than cash equivalents	2	2,950	10	-	2,960
Reinsurance recoverables	#	224	-	-	224
Insurance and intermediates receivables	#	290	-	-	290
Receivables (trade, not insurance)	#	21	-	-	21
Cash and cash equivalents	#	1,174	(10)		1,164
Any other assets, not elsewhere shown	#	9	-	-	9
Total Assets	#	13,630	-	(52)	13,578

#- Disclosure note not provided as solvency value equal to IFRS or the amounts are immaterial.

1. Deferred acquisition costs

For Solvency II valuation purposes, deferred acquisition costs are set to nil however the cashflows relating to DAC-able expenses, are included within the Technical Provisions valuation if they fall within the projected timeframes.

2. Investments

Following the purchase of TAC in June and the renewal of all existing business into LVIC, TAC is now in run-off. Consequently, in line with the companies diminishing liabilities, all the assets of TAC were moved into highly liquid OEIC's (which are invested in cash and cash equivalents) or cash deposits to match projected underwriting future liabilities. The movement between Cash and Deposits other than Cash Equivalents represents a presentational reclassification under Solvency II of a custody account.

D.2 Technical Provisions

The table below summarises the technical provision recorded as at year end 2016:

	2016		
	IFRS	Var	Solvency II
	£0	£0	£0
TP; Non-Life (excluding health)			
- TP calculated as a whole	1,617	(1,617)	-
- Best Estimate	-	1,565	1,565
- Risk Margin	-	426	426
Total technical provisions	1,617	374	1,991

With regards Guidelines 29 (1.43) of EIOPA-BoS-15/109⁵, there are no third country insurance or reinsurance undertakings within the Group and accordingly, no further disclosures are provided here.

Overview

Due to materiality, the best estimate liability (BEL) is derived from the underlying IFRS Reserves for Solvency II valuation purposes. It comprises a separate calculation of a claims provision and a premium provision which, when added together, derive the BEL. The Risk Margin (RM) represents the cost of holding the SCR over the future assumed lifetime of the insurance portfolio, assuming a percentage annual cost.

For Solvency II valuation purposes, the BEL is calculated gross of reinsurance recoverables, which are calculated separately.

Best Estimate Liability (BEL)

The BEL for TAC composes a separate calculation of a Claims and Premium Provision, which are added together to derive the BEL.

The claims provision covers expired risk, i.e. the cashflows in relation to claims incurred prior to the calculation date. Given TAC is now in run-off and the duration of the outstanding liabilities is low, the Claims Provision has been set equal to the IFRS Claims Reserve. Typically, the Claims Provision would allow for the impact of discounting (reducing the provision) and an allowance for Events Not In Data (increasing the provision). As these offset each other directionally and are both likely to be immaterial, these have not been included.

The premium provision covers unexpired risk, i.e. the cashflows in relation to business in force at the calculation date, together with business that has been accepted but not incepted. This would typically include new business transacted before or on the valuation date but which will commence after the valuation and also tacit (inertia) renewal cases, whereby a contract is deemed to be established by TAC's commitment to renew the policy unless informed otherwise by the policyholder.

Again, due to materiality and the fact that TAC is now in run-off, the Premium Provision has been set equal to the IFRS Unearned Premium Provision net of Deferred Acquisition Costs. This is considered to be a reasonable approximation based on the two larger General Insurance entities within the LV= Group.

Both provisions are calculated on a gross of reinsurance basis, with an explicit calculation of the reinsurance provisions separately.

Risk Margin

⁵ Final Report on public consultation No. 14/047 on Guidelines on reporting and public disclosure

The calculation of the Risk Margin (RM) is part of the overall process of producing the Solvency II Balance Sheet for TAC. The RM represents the cost of holding the SCR over the future assumed lifetime of the insurance portfolio, assuming a percentage annual cost. However, rather than being based on the full SCR the RM for each entity is calculated on the following premises:

- The risk margin is the present value of the cost of capital that a third party insurer would need to hold assuming it took on the insurance liabilities.
- This third party has no other insurance liabilities and is closed to new business.
- The risk capital considers only market risk (excluding hedgeable market risk), GI underwriting risk, counterparty risk and operational risk.
- There is no allowance for deferred tax loss absorbency.

The risk margin would typically be calculated using a cost of capital (CoC) approach i.e.:

$$Risk\ Margin = CoC * \sum_{t>=0} SCR_t / (1 + r_{t+1})^{\wedge(t+1)}$$

Where:

- The sum covers all future time periods 't' including time zero.
- 'CoC' is the annual cost of capital which, has been specified as 6%.
- 'SCR_t' is the SCR at time 't' in respect of the risks included with the RM calculation.
- The projection of the SCR will be carried out for the assumed run-off term of the in-force business, i.e. no new business is assumed.
- 'r_{t+1}' is the basic risk free rate for maturity 't' allowing for the term structure of interest rates with no allowance for illiquidity premium.

However, due to materiality and the fact that TAC is now in run-off, the calculation has been simplified by assuming the opening Solvency Capital Requirement will be held at only the beginning and end of the year following the valuation date, with no discounting being applied. The calculation above therefore simplifies to:

$$Risk\ Margin = 2 * CoC * SCR_0$$

Recoverables from reinsurance contracts and special purpose vehicles

For Solvency II valuation purposes, reinsurance recoverables are set equal to the IFRS equivalent amount.

D.3 Other liabilities

For solvency valuation purposes, assets and liabilities are valued consistently with IFRS provided that IFRS valuation methods are consistent with Article 75 of Directive 2009/138. Assets and liabilities represent the fair value amount for which they could be exchanged between knowledgeable willing parties in an arm's length transaction.

The financial statements of the undertaking have been prepared in accordance with:

- International Financial Reporting Standards (IFRS), as endorsed by the European Union ('EU').
- International Financial Reporting Interpretations Committee ('IFRIC').
- Statement of Recommended Practice issued by the Association of British Insurers (2005), amended 2006.
- those parts of the Companies Act 2006 applicable to companies reporting under IFRS.

	Note	2016			
		IFRS	Presentational adjustment	Solvency valuation adjustment	Solvency
		£000	£000	£000	£000
Provisions other than technical provisions	#	250	-	-	250
Payables (trade, not insurance)	#	601	-	-	601
Any other liabilities, not elsewhere shown	#	300	-	-	300
Total Other Liabilities	#	1,151	-	-	1,151

#- Disclosure note not provided as solvency value equal to IFRS or the amounts are immaterial.

D.4 Alternative methods for valuation

The following material assets have been valued using alternative valuation methods in accordance with Article 263 of the Delegated Acts:

- 1) Insurance and intermediaries receivables are valued consistently with IFRS. Management believe this to be representative of the fair value at the reporting date.
- 2) Reinsurance recoverables from Non-Life excluding Health £224k; this has been valued using the cash flow projection method, in a consistent manner with the calculation of the best estimate liabilities and adjusted for expected losses due to the default of reinsurance counterparties. Further information regarding the best estimate liabilities can be found earlier in Section D.

The following material liabilities have been valued using alternative valuation methods in accordance with Article 263 of the Delegated Acts:

- 1) Best Estimate Liability and Risk Margin £1,991k; this has been valued under Solvency II methodologies and further information can be found earlier in this report.
- 2) Payables (trade, not insurance) £602k; trade payables are valued consistently with IFRS. Management believe this to be representative of the fair value at the reporting date.
- 3) Provisions other than technical provisions are valued consistently with IFRS. Management believe this to be representative of the fair value at the reporting date.
- 4) Any other liabilities include current tax payable and are valued consistently with IFRS. Management believe this to be representative of the fair value at the reporting date.

D.5 Any other information

The bases, methods and main assumptions used at a group level for the valuation of solvency purposes of the group's assets, technical provisions and other liabilities does not differ materially from those used by TAC.

E. Capital Management (TAC)

E.1 Own funds

The key capital management policies and objectives for TAC are set at Group level and consistent across all entities. The approach to measuring and monitoring capital for TAC is defined and actioned at Group. In addition the Group backs all the underlying entities and has in place mechanisms to support these capital positions if necessary.

For further information on these please see section E.1a and E.1b of the Group section of this report.

The following table details the structure, amount and quality of basic own funds.

	Tier 1 £000	Tier 2 £000	Tier 3 £000	Total £000
Ordinary share capital (gross of own shares)	4,000	-	-	4,000
Reconciliation reserve	6,436	-	-	6,436
Subordinated liabilities	-	-	-	-
Total Basic Own Funds	10,436	-	-	10,436
Total available Own Funds to meet the SCR	10,436	-	-	10,436
Total available Own Funds to meet the MCR	10,436	-	 	10,436

The following tables detail the eligibility of own funds to meet the SCR and MCR.

Total available Own Funds to meet the SCR	10,436	-	-	10,436
Total eligible Own Funds to meet the SCR	10,436	-	-	10,436

Total available Own Funds to meet the MCR	10,436	-	 	10,436
Total eligible Own Funds to meet the SCR	10,436	-	 	10,436

No own funds has been reported for the prior year as allowed by article 303 of the Delegated Regulations

Analysis of significant changes in own funds during the reporting period

	TAC		
	Day 1 2016 £000	Movement £000	Annual 2016 £000
Eligible own funds			
Tier 1 capital	9,486	950	10,436
Total capital	9,486	950	10,436
Made up by:			
Equity shares	4,000	-	4,000
Reconciliation reserve / surplus	5,486	950	6,436
Total capital	9,486	950	10,436
Total eligible own funds to meet SCR	9,486	950	10,436

- Tier 1 capital includes movements in excess of assets over liabilities.
- There have been no distributions made to shareholders during the reporting period.

Ancillary own funds

At 31st December 2016 there are no ancillary own funds.

Deductions from own funds

At 31st December 2016 there are no deductions from own funds

Explanation of the key elements of the reconciliation reserve

Reconciliation reserve	£000
Retained earnings on a solvency basis	6,436
Total	6,436

TAC did not apply any loss absorbency mechanisms as at the end of 2016.

Material differences between equity as shown in the undertaking's financial statements and the excess of assets over liabilities as calculated for solvency purposes

The following table provides a reconciliation of equity under IFRS to Solvency II excess of assets over liabilities.

	£000
Analysis of Equity - IFRS	
Ordinary shares, allotted and fully paid	4,000
Retained earnings	6,862
Total Equity - IFRS	10,862
Solvency II Adjustments (excluding reclassifications)	
<u>Assets</u>	
- Reduction in valuation of DAC (Section D1)	(52)
	(52)
<u>Technical provisions</u>	
- Increase in valuation of technical provisions (Section D2)	(374)
<u>Other liabilities</u>	
- Other	0
Total Equity -solvency basis	10,436
Restricted own fund items due to ring fencing	0
Restricted own fund items due to subordinated liabilities	0
Total own funds -solvency basis	10,436

Excess of Assets over Liabilities -solvency basis	
Total Assets	13,577
Total Technical Provisions	(1,991)
Total Other Liabilities	(1,150)
Excess of Assets over Liabilities -solvency basis	10,436

Differences in the asset and liability valuation methodology used for solvency purposes and that used under IFRS are set out in Section D.

Own-fund item that is subject to the transitional arrangements

TAC has no own funds subject to transitional measures

E.2 SCR and MCR

E2.1 SCR and MCR

The following table shows the amount of the SCR and MCR for TAC.

	£(000)
SCR	3,605
MCR	2,251

Following the purchase of TAC in June and the renewal of all existing business into LVIC, TAC is now in run-off. The SCR was broadly unchanged over the reporting period, with an increase in catastrophe risk due to the ceasing of reinsurance cover at the end of 2016 offset by the run-off of in-force business.

The calculation of the MCR is laid out in the S.28.01.01 QRT included with this report. The MCR is determined using a calculation, as specified in the Solvency II regulations, involving the technical provision, capital at risk and SCR, subject to a floor specified in Euros and converted to pounds sterling. The MCR floor of €2.5m applied throughout the reporting period and as such the MCR only increased over the reporting period due to a change in the Euro/Pound exchange rate.

E2.2 SCR split by risk

The following table summarises that risk modules which contribute to the Solvency Capital Requirement applicable under standard formula as at 31st December 2016:

SCR Component	(£000)
Market risk	0
Counterparty default risk	804
Life underwriting risk	0
Health underwriting risk	0
Non-life underwriting risk	3,079
Diversification	(333)
Intangible asset risk	0
Basic solvency capital requirement	3,550
Operational risk	56
Loss-absorbing capacity of technical provisions	0
Loss-absorbing capacity of deferred taxes	0
Solvency capital requirement excluding capital add-ons	3,605
Capital add-ons already set	0
Solvency capital requirement	3,605

No material simplifications have been adopted in the calculation of the SCR under standard formula.

E2.3 Basis of calculation

TAC uses a Standard Formula basis to calculate the SCR. The approach to calculating the SCR and MCR is in accordance with the Solvency II Directive. TAC is not using any material simplifications or undertaking specific parameters in the calculation of the SCR and does not have any regulatory capital add-ons.

E.3 Use of a duration-based equity risk sub-module

TAC has not applied the duration-based equity risk sub-module in the calculation of the SCR.

E.4 Differences between Standard Formula and any Internal Model used

This does not apply as TAC does not use an Internal Model to calculate its SCR.

E.5 Non-compliance with the MCR and the SCR

TAC has been compliant with the MCR and SCR throughout the reporting period.

E.6 Any other material information

No additional information is disclosed because all relevant information has been provided above.